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American Business Series

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GENERAL EDITOR

BUSINESS OWNERSHIP ORGANIZATION

BY
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PREFACE

THE subject of business organization has usually been approached from one of two points of view. The first of these approaches is from the standpoint of the principles and problems involved in building up the legal form of organization under which the business is to be owned, and that bear upon the relations of the entrepreneur, the creditor and third parties to one another and to the business establishment itself. The second strikes the problem from the angle of the technique involved in making those internal arrangements that are necessary or desirable to secure efficiency in the administration and operation of the enterprise. For the sake of brevity, we shall call the subject-matter of the first ownership organization and of the second administrative organization. It is the former with which this work has to do.

Most writers on the subject of ownership organization in business have been lawyers, a circumstance which has so influenced their work that they have almost invariably limited their writings to a consideration of the legal aspects of parts of this broad subject. Thus we have numerous treatises on the law of partnership, on corporations, on trusts, etc., that are intended to appeal primarily to the student of law. As a result they fail to interest the student of applied economics, for they lack that broadness of view that is so essential to a full understanding of the intricacies of organization of the present system of business ownership.

The legal institutions that form the basis of the ownership forms of today have very largely developed from social custom, in consequence of which they differ somewhat in principle, form and application from country to country.

They were nearly all in existence long before the industrial revolution ushered in the modern era of big business enterprise. They had to be adapted to meet those new conditions that were brought about by large scale production, a widened concept of business capital and the economic forces driving competing business establishments into monopolistic and semi-monopolistic combines. These powerful influences have played a far more important part in shaping the modern forms of ownership organization than can be ascribed to legal principles and differences.

A study of the business ownership organizations of today is, therefore, something more than a mere analysis of legal forms. It is the application of these forms to business uses in the light of the modern industrial system. This is the point of view that has been uppermost in my mind during the preparation of this brief exposition; and it is my hope that, through this work, the general public, as well as the student of applied economics will be enabled to obtain a clearer picture and a fuller understanding of the ownership of business than has heretofore been possible.

A. H. S.

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PART I
ECONOMIC AND LEGAL FUNDAMENTALS

CHAPTER I

THE CONCEPT OF CAPITAL AS THE FOUNDATION OF OWNERSHIP ORGANIZATION IN BUSINESS

The Business Establishment Defined.—When we seek to secure profits through some organized activity, we have a business undertaking or establishment. It may be defined as a complex of labor and capital brought together and directed by an entrepreneur for the purpose of profit. Labor, under this definition, includes all human effort, whether mental or physical, directed toward the prosecution of the enterprise. Capital includes all money and securities, natural resources and products, other than labor, that are used in the business. The head of the enterprise is called the entrepreneur by economists. He is the one who, besides risking his capital, or command over capital, in the venture assumes the final responsibility for its management and direction. However, under present-day conditions, business is in large part conducted by groups of individuals combined into an organization, such as a corporation, a partnership, a joint stock company or some other form. These organizations may therefore properly be considered entrepreneurial or ownership organizations. It is of such organizations that this work treats.

The Private versus the Public Entrepreneur.—While the entrepreneur is ordinarily a private person or an association of persons, this is not always the case. A municipal, state or national government may become an entrepreneur by going into business. European governments

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have frequently done this, but in the United States there has been a marked antipathy toward this. Nevertheless, even in this country, many municipalities own and operate gas plants, electric plants, street railway systems and other enterprises. And during the recent war the national government went into shipbuilding and the manufacture of munitions on an extensive scale. But a distinction must be made between the government as an entrepreneur and as an operator. The act of the government in taking over the railways, the telegraphs and the telephones and other national equipment, and operating them did not make the government the real entrepreneur for it did not assume the full ownership responsibility.

The Function and Classification of Business Establishments.—In a broad sense, the function of the business establishment is the production of economic goods which may be used, directly or indirectly, to satisfy human wants. It is ordinarily conceived to include the production, or the purchase and sale of commodities or both, that is to say, manufacture and trade. The work of assembling, transporting, storing, grading, assumption of risk and financing is merely incidental to the chief function, but even these services are the bases for a vast number of business enterprises. Others, again, render different services, such as advertising, the collection and dissemination of statistical data, the communication of ideas. In fact it is almost impossible to enumerate the vast number of different kinds of business undertakings that are to be found in a modern industrial country. However, for the purpose of convenience they may readily be classified under a few suggestive heads. The following classification is one that is usually employed in government publications.

1. *Agriculture, animal husbandry and fisheries*, having to do with the growing, raising and direct appropria-

tion of vegetable and animal products for human consumption.

2. *Mining and quarrying*, or the original recovery of the useful mineral products from the earth.

3. *Manufacturing*, the process whereby the raw products of the first two groups are transformed into consumable products.

4. *Construction*, the work of creating in final form the more or less permanent equipment of a country such as, buildings, canals, railways, docks, bridges, industrial plants, etc.

5. *Transportation and other public utilities*, which include the operation of water, gas, and electric works, railroads, telephone and telegraph lines, etc.

6. *Trade*, comprising the purchase for sale of goods, wares and merchandise by retailers, wholesalers, commission men, brokers, factors, etc.

7. *Personal service* including the professions, amusements, domestic services, etc.

8. *Finance, banking and insurance* and similar undertakings that are of a fiduciary character.

Social Custom, Business Enterprise and Economic Development. — The form of the business unit, the method by which it conducts its operations, the privileges that it enjoys, as well as the limitations and restrictions placed upon it are deep rooted in the social and economic structure. Consequently any changes in social concepts and customs or in economic practices are bound, in the course of time, to bring about sympathetic changes in the business unit. Social and economic transitions ordinarily take place gradually; but at times, as the result of wars or other unanticipated catastrophes, they may be extremely rapid. Thus we find the hoary institutions of private property and inheritance, which are the foundation stones of modern busi-

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ness organization, gradually losing their dignity as rights and assuming the plainer garb of privileges. For the "right" of inheritance is now limited by heavy inheritance taxes, while the "right" of private property is subject to eminent domain, and in some European countries it is being threatened with the imposition of so-called capital levies which would appropriate a large share of private wealth to defray the obligations of governments. Indeed, the complete abolition of these two institutions has been strongly urged by the Marxian Socialists, and the Bolsheviks and others. This simply illustrates a change in social concepts. It cannot be denied, that the complete abolition, either of one or of both of these institutions, would have a very marked and far-reaching effect upon the form of the business unit, in that it would take business completely out of the hands of the private entrepreneur. We have but to bear in mind the demands made upon the governments of the United States and of the United Kingdom for the nationalization of railways, coal mines, and other fundamental industries, to realize how close to our daily life such changes are. Social changes are inexorable in their execution; for they are backed by the force of general public opinion to which the individual must inevitably bow.

But it is not social custom alone that determines the nature of the business unit. Many types of business forms are the direct outgrowth of economic development. The great industrial plants of today employing tens of thousands of workers and millions of dollars' worth of machinery and equipment in their manufacturing processes, are of relatively recent development. Their structure rests upon the foundations laid by the great mechanical inventions of the latter part of the eighteenth century that ushered in the industrial revolution. Prior to that time, manufacturing was done very largely by hand methods in the home of the

worker who enlisted the services of the members of his family to aid him in his work. But all this has changed. Today the factory system dominates our industrial life, markets are no longer limited, but are world wide, competition is no longer domestic but has become international. It would have been strange, indeed, had these revolutionary economic changes brought about no new developments in business organization and practices.

Economic development usually proceeds at a somewhat more rapid pace than change in social customs or concepts. Inertia and stability are the marked characteristics of the latter. We do not like to change our mode of life; and when economic forces begin to press upon us, we are inclined to appeal to the political institutions that we may have set up as government to secure legislation against the threatened change. In this we attempt to retard or forestall the inevitable economic development. History furnishes us with many examples of laws and ordinances against the use of various mechanical appliances introduced to supplement hand manufacturing processes. Stringent laws against usury were passed to prevent the lending out of money at interest. Trade unions, also, were vigorously suppressed by law when they first began to assume importance. The legal fights against monopoly of raw materials in certain industries, and of markets in others, is still a moot question of the day in the United States. But legislation cannot definitely block general economic development when the latter takes place normally and spontaneously. In such cases social custom will, through steady and continual pressure, be forced into a new mold, finally tolerating as factors in the social system economic institutions that it found it difficult or impossible to suppress.

Between the forces of economic development and the counter forces of social custom, we find the business institution plastic, yielding to pressure applied here or there

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when the impelling force is strong enough, and resisting if the force is weak. Under these conditions plasticity rather than rigidity characterizes the business institution, and scarcely a decade passes that does not leave some mark of change upon its features.

The Concept of Capital and its Influence upon the Ownership Organization. — The types of business organization employed in the conduct of business at a given time are simply phenomena attendant upon a given stage of economic development. The fundamental element that distinguishes one type from another is found to be the relationship that exists between the entrepreneur and his business undertaking as well as the character of the capital risk that he assumes. The concept of capital, therefore, is the keystone of the whole arch. Society having once fully accepted a given concept of capital or wealth that has arisen out of economic development thereby places the stamp of approval upon the particular type of business organization that is built up around that concept. This does not mean to convey the idea that all types of business organization at a given time are based upon the latest development in the concept of capital; for such is not the case. A new concept of capital does not supplant its predecessors but rather is added to them. For this reason the types of business organization prevailing today are the accumulated products of economic and social progress.

In order to enable the reader to understand clearly the distinctions differentiating the several types of present-day business organization, it will be necessary to sketch briefly the development of the economic stages based upon the changing concept of what constitutes business capital. Beginning with the dark ages following the collapse of ancient civilization, three such economic stages can be distinguished. First, that stage in which the concept of capital is restricted to commodities; second, in which it is widened to include

money in addition to commodities; and third, in which it is still further extended to include securities in addition to the other two.

There are no clear-cut breaks separating one of these periods from another. The transition is gradual. It develops like the transportation system of a new country. At first wagon roads are sufficient to meet its requirements, and to give it access to the outside world, but it may grow, and the time will come when the wagon road will no longer suffice. A railroad is now constructed to operate side by side with former means of transportation. Later on a street railway system or a canal makes its appearance. Thus, where we at first had but a single avenue of trade we now have many. The great volume of business will naturally follow the most serviceable channel while the others would be used as supplementary vehicles. And so it is with the several forms of ownership organization that are in use today. They have been of gradual development. New types have been evolved as new needs arose, only to be added to those already in existence. But, before these new types can be used effectively the capital concept must first have become sufficiently broad to give new life to the form. To trace in full the development of the concept of business capital, would require far more space than the limits of this work permit. Consequently only the briefest and simplest explanation will be attempted.

1. *The stage of goods as capital.*—This first stage of economic development is characterized by a limitation of the concept of capital so as to include only goods or commodities. A man's wealth is based upon his possession of things and he is spoken of as rich or poor according to the number of cattle, acres of land, bushels of wheat, etc., that he owns, without ascribing to them a money value. The method employed in effecting business transactions in

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this stage shows a gradual transition from the practice of simple exchange of one commodity for another to transactions based upon money as a common medium of exchange. For convenience let us, then, divide it into two periods: (a), the simple barter period and (b), the medium of exchange period.

(a) *The barter period.*—In the barter period the business transaction consists of a direct exchange of one good or commodity for another without the use of money. The merchant brings his wares with him and takes away those wares for which he has exchanged his own. The difficulties standing in the way of a free exchange of commodities under this system militate against any pronounced development of commerce and tend to make communities as nearly self-subsisting as possible. Itinerant merchants who negotiated single transactions were fairly common, and the practice soon grew of holding periodic fairs to which all could bring their surplus products to barter them off for what they might happen to need. Such transactions ordinarily necessitated an actual contact between the buyer and the seller, a personal inspection of the wares and an agreement as to the basis of exchange. In consequence of these difficulties, permanent business establishments such as we have today can hardly have existed. Barter trading is still carried on in civilized communities in a desultory way and with the uncivilized natives of certain parts of the world, as in the Kongo region, where the European trader exchanges his glass beads, trinkets, and cutlery for ivory and rubber, and among the African natives themselves. More permanent business establishments of this class are the fur trading posts of the Canadian northwest. The amount of business done in this way is, however, quite insignificant when compared with the total transactions of any industrial country.

(b) *The medium of exchange period.*—In the second

period of this stage a general medium of exchange is introduced into the business transaction to facilitate trade. At first this may be simply a product common to the community. Thus rice, beaver skins and tobacco were used for such a purpose by the early English colonists in North America. This good then becomes the measure of value for all others while it, at the same time, retains its intrinsic value. Such media of exchange are usually somewhat bulky and inconvenient, and are eventually discarded for a universal medium that may be simply a token, of little or no intrinsic value, as the wampum of the North American Indian or the sea shells of the South Sea Islanders. But even these gradually give way to metallic money whose qualities of divisibility, durability, universality, high exchange value and relative light weight, etc., make it an excellent medium of exchange. With this development the act of making business transactions is greatly facilitated. It now becomes possible, as well as convenient, to establish permanent business where transport facilities permit of bringing together a sufficiently diversified stock of goods. The fairs which were the most prominent characteristic of business in the preceding period wane and become gradually of less and less importance, until they give way almost entirely to permanent establishments operated as individual proprietorships or partnerships.

However, throughout this whole stage money itself is not looked upon as wealth, but merely as a convenient medium of exchange. Its use, to be sure, gradually increases, especially with the merchants who employ it extensively to facilitate their business transactions, but who, nevertheless, derive no direct profit from it. Public opinion is not ripe for this, and attempts on the part of merchants or other possessors of money to thus utilize it, for example, by levying taxes in terms of money instead of in kind or by

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lending it out at interest, meets with strong disapproval. This reflection of the public sentiment is well illustrated by the numerous laws and bans of the church against usury, so common in Europe during the early middle ages.

2. *The money capital stage.*—In the preceding stage we have seen how money gradually becomes an important element of the business transaction. At what point, then, does it begin to be looked upon as capital? The extension of the concept of capital simply follows the natural channel of economic progress. As the merchants and traders were the first to employ money quite generally in their business, they soon found it convenient to value their stock of goods, to keep their accounts and to calculate their profit and to pay their taxes in terms of money. A stock of goods to them was a money investment from which they sought to derive an income. Here then, is the embryo that later develops into the concept of money capital. In the preceding period personal labor was looked upon as the only source of income, for then the idea of the productivity of capital did not exist, merely because it was not calculable. The idea of income, the striving to derive a return from capital is the great characteristic of capitalistic industrialism. It is at this point, also, where the distinction between the capitalist and laborer arises. The laborer works only by request or order, whereas the capitalist entrepreneur produces for stock or for the market. Naturally the entrepreneur assumes an entirely different element of risk than the laborer, for he risks not only the capital tied up in his wares, but eventually also that represented by his business plant and equipment. Capital risk is a characteristic of the money capital stage of industry that distinguishes this from the preceding stage. It cannot be held, however, that the wage worker assumes no risk; for he does assume a risk which, under certain conditions, may be greater and more dangerous than that

of the capitalist, namely, the risk of failure to secure sufficient work to sustain himself. But this distinction is to be noted — he cannot calculate his risk in terms of money. Money, then, becomes capital only when the possessor thereof can derive an income from it by risking it indirectly in the form of wares, plant, equipment, etc., valued in terms of money, or directly in the form of a money loan.

The above definition clearly distinguishes between two periods of money capital: first, when it is used as the chief measure of value for commercial and industrial undertakings; and second, when it is employed directly as loanable funds. The first period may be called the *commercial capital* period. It is in this stage, then, when it first becomes possible to establish a business with stock, equipment, wares, etc., procured with borrowed funds. This period witnesses the development of great commercial undertakings, while the second is characterized by the rise of business institutions peculiarly adapted to handle money capital, e. g., banks, and at a somewhat later time exchanges. It is out of these two roots that the concept of securities capital has grown. Out of commercial capital arise *stocks*, the chief form of ownership securities, and out of loan capital *bonds* or credit securities.

It is of course self-evident that neither money, nor securities create new economic capital. The lender of money to a business undertaker and the purchaser of bonds, secures thereby only the right to demand a share of the earnings which the debtor seeks to procure from the productive use of his economic (commodity) capital or his personal services. But from the standpoint of the economist these borrowed funds become capital only when they are risked by investment in some enterprise, as in transforming them into commodity capital. It is merely a complex process of substitution, whereby capital funds are made fluid and become generally available to those entrepreneurs who pos-

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sess insufficient quantities in their own right properly to conduct the enterprises which they undertake.

The entrepreneurial organization, — the form of organization under which business is conducted, — shows in this stage great development and change. To the individual proprietorship and the partnership are now added new forms. Joint undertakings, or "joint adventures" as they are also called, with ownership represented by divisible, transferable shares; joint stock companies with their indivisible shares, and the corporation make their appearance.

This development coupled with the economic advancement brought about by the great mechanical inventions of the industrial revolution in the latter part of the eighteenth century stimulate a rapid growth in the size of business units. They demanded vast sums of capital which could not be secured without the use of securities as instrumentalities of organization.

By the general term "securities" we mean that class of commercial paper that is issued in large numbers of units of like denomination and kind for a relatively long term of years, that are freely interchangeable and transferable, and to which attaches a right to a share in the earnings of the business and a claim to the capital which they represent. They are of two types: stocks which represent an ownership interest or contributions of capital to remain permanently in the business, and bonds representing a creditor's interest or funds loaned to the business but which must be returned to the holder of the bond at a definite time.

As long as it was impossible to give to real or money capital the security form, an entrepreneur who had insufficient capital in his own name could round out his requirements only by personal dealings with someone who had real or money capital to lend. The institution of credit, as

well as the entrepreneurial organization, from the individual proprietor to the most ramified type of partnership, without the concept of securities capital, must rest upon a personal relationship, a legal joint contract between the parties at interest. But how different the joint stock company and the corporation! Not only are money funds made available through fluidity, but even the real, or goods capital, of enterprises becomes fluid in so far as ownership is concerned. The possessor of a small quantity of ready funds can, by utilizing them in the purchase of securities, become a participant in the largest industrial or commercial undertakings of the day. In so doing, to be sure, he assumes the risk attendant upon an entrepreneurial relationship, or as a creditor, to such enterprises, but his chances of obtaining a relatively large profit are good, perhaps even better than he might obtain by turning his money over to a bank in the form of a savings deposit. The outstanding effect of widening the source of funds for business undertakings through the issue of securities has increased correspondingly the number of those whose income consists only of the returns from their security investments; in other words, who enjoy an income quite independent of any labor on their part. During the stages previously discussed such an income was possible only to a comparatively limited degree, as when a land owner let his land out on a long time lease to others. For even if he had large sums of money to lend out, he could have done so safely only by diligently investigating the risk entailed by each individual loan, basing his decision largely upon the personal character and estimated business ability of the borrower. One is quite safe in saying, that it would have been impossible to bring together the vast quantities of capital employed by our great modern industrial and commercial establishments without first having evolved a plan of making the possession of real capital, privately owned, an impersonal matter.

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This the use of securities as instrumentalities of organization has succeeded in doing without breaking down the idea of private property.

3. *The Securities Capital Stage.*—However, the idea of the use of securities as business capital has not attained its complete development with the general use and acceptance of securities as instruments of organization. The development must go still further until the entire business capital of an enterprise may consist essentially of the securities issued by other business organizations to the practical exclusion of the other forms of capital, so that a new business may be formed to issue securities to represent a capital that consists entirely of securities. This concept now prevails in all of the more advanced industrial and commercial countries of the world.

To that class of business organization that issues securities to represent a capital consisting in greater part of securities of other concerns, Professor Robert Liefmann has aptly given the name of securities-substitution companies.¹ They embody the principle of the holding corporation and include such types as the control company, the investment trust, the finance company and the assumption company. While they create new business enterprises, they do not add to the producing equipment of the country in which they exist. They are essentially organizations that withdraw securities from the public to hold them in reserve in vaults and banks in order to accomplish the purpose for which they were organized; whether this be to continue existing organizations under a single control, to average the profits accruing to a large variety of securities, to finance new securities-issuing companies or to relieve finance companies from an overburden of securities. They are the highest, as well as the most flexible and elastic type of ownership organization that has, as yet, been developed.

¹ Robert Liefmann, *Beteiligungs und Finanzierungsgesellschaften*, Jena, 1913.

Influence of Large Scale Production and Competition on Organization. — While the development of the concept of business capital has called into being certain new forms of ownership organization, large scale production and competition have given an impetus to the revival of old and time-worn institutions to bring about closer co-operation between business enterprises within the same industry. The productive capacity of established enterprises is keyed up to meet a maximum demand for goods. But this demand, influenced by many economic factors, is constantly fluctuating — now increasing rapidly, now falling off. The modern business establishment must operate at somewhere near maximum capacity to be profitable, and consequently the effect of fluctuations in the demand for its products tends to bring about a state of “cut-throat” competition, that must naturally result in a battle for the survival of the fittest. The result is combination.

Combination in industry may be for the purpose of assuring the combining units a share of the market for their products, for the purpose of assuring themselves supplies of raw materials to enable them to produce at lower costs, or to obtain a monopolistic command over the industry. These forces, as will be explained more fully in later chapters, give rise to new forms of organization, which, however, largely make use of the prevailing forms of ownership organization, supplemented by the legal institution of contract. Thus, we have, today, commercial associations, chambers of commerce, factors, agreements, pools and kartells, and monopolies and trusts.

While it is not the purpose of this work to go into an exhaustive study of the problems incident to combinations and trusts, the work would be lacking in completeness, were we to omit a description of these most important forms of organization. But to do more than this would necessitate an expansion of the work beyond the limits indicated by its title.

CHAPTER II

THE LEGAL FOUNDATION OF ORGANIZATION IN BUSINESS

THE economic principles laid down in the preceding chapter are of general application in all modern industrial countries, and through these they have influenced the types of ownership organizations that are to be found in less developed lands. But, at best, these principles furnish us only the skeleton of the organization without the technical arrangements which are so necessary to give it life. These technical arrangements are prescribed and defined by common and statute law in each country. The result is, that, while the corresponding forms of organization are recognizable from country to country, they nevertheless, exhibit considerable variation. The legal foundation upon which they must be erected in a given country may differ radically from that of another. Thus a thorough knowledge of the commercial or business law of each nation would be necessary for a complete understanding of its ownership organizations. However, rather than to attempt to describe the vast multitude of technical legal requirements pertaining to this subject that are to be found in the larger industrial countries, we shall confine ourselves for the most part to a consideration of those that prevail within the United States and refer only incidentally to variations to be found in other countries.

The Legal Foundation. — The system of jurisprudence of the United States is of English origin. It is a bifurcated system made up of the common law and the statute law. The *common law* consists chiefly of an accumulation, over

a period of many centuries, of customs as interpreted by court decisions and consequently is based almost entirely upon precedent. *Statute law* comprises all acts of the state and federal legislative bodies in so far as they are within the constitutional limitations set by the people. Statutes modify the common law principles wherever the two do not agree. Hence, in any application of law, the federal constitution is held to apply first, the state constitutions second, the statutes third and the common law last, each, however, within its own sphere of jurisdiction.¹

In the United States, the influence that government has on business is of a two-fold nature; on the one hand, that exercised by the state governments, and on the other, that exercised by the federal government. The effect of the tenth amendment to the constitution of the United States is to make the federal government one of delegated powers only, while all residual powers remain vested in the individual states. It follows, therefore, that any state may freely pass any legislation affecting business, except in such matters as are specifically reserved to the United States or denied the several states by the federal constitution, or are found to be contrary to the provisions of the constitutions of the several states.

Among the more important restrictions on the power of the states to legislate upon business or to interfere with it, are prohibitions against laws impairing the obligation of contracts, laws seeking to deny to the citizens of each state the privileges and immunities of the citizens of the several states, and laws seeking to levy duties on imports and exports of any other state, which naturally would be legislation on interstate and foreign commerce, control over which is vested in the federal Congress.

The powers delegated to the United States Government

¹ It should be noted that the State of Louisiana does not follow the English law but has adopted in a modified form the Napoleonic Code of France.

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that affect business more or less directly are contained in Section 8 of Article I of the Constitution. They include the following:

1. To regulate commerce with foreign nations and among the several states
2. To establish uniform bankruptcy laws throughout the United States
3. To coin money and to provide a system of currency
4. To fix the standard of weights and measures
5. To establish post offices and post roads
6. To grant patents, copyrights and trade-marks
7. To levy taxes, duties, imposts and excises
8. Under the sixteenth amendment to the constitution, to levy and collect taxes on incomes.

Section 9 of Article I of the Constitution places certain restrictions upon the power of Congress to legislate on matters affecting business. It prohibits Congress from levying export duties on articles exported from any state, from favoring the ports of one state as against the ports of another through any regulation of commerce or revenue and from levying duties on vessels engaged in interstate trade.

Federal Laws and Entrepreneurial Organization. — It is, therefore, apparent that privately conducted business is more intimately concerned in the regulatory laws and acts of the several states than in those of the federal government. But the growth in size of the average business establishment, the extension of markets and the efficiency of transportation systems has made American big business characteristically interstate, and because of this, the weight of federal statutes regulating interstate commerce is exerting an ever-increasing pressure on the business world, in this way bringing the business man into more intimate relationship to the federal government.

Moreover, the continuation of the process of integration and concentration of commerce and industry through the combination and absorption of business units by others, resulting in such gigantic business establishments as the United States Steel Corporation, the Allied Packers, and the United Retail Stores and hundreds of others, will, in the near future, make it imperative upon the federal government to extend its legal control, not only over their methods of competition, but also over their ownership relations. This does not mean that the federal government has kept its hands off business; for it has, on the contrary, passed many laws against combinations in restraint of trade, regulating railways, etc., but in the main, its legislation has been confined to regulation of interstate commerce, and to attempts to preserve a state of free and fair competition. These acts, in so far as they affect business organizations, apply largely to the higher types. An explanation of them is, for this reason, deferred to a following chapter.

State Laws and Entrepreneurial Organizations. — Under the English common law nearly all of the types of entrepreneurial or ownership organization that now are in general use might be formed, though, in some cases, with considerably restricted powers. Such entrepreneurs as found it desirable to secure advantages in the matter of business organizations which the common law did not afford, found themselves obliged to appeal to some state legislature to secure a special act empowering them to enjoy, and to use, the desired privileges. This condition resulted in fraud, bribery and many other abuses carried to an unheard of extent. Finally, the people of the several states, tiring of these practices, prevailed upon their legislatures to adopt general laws that would apply to all alike. These general statutes apply, in general, to all types of organizations in which the risk of loss of the entrepreneur is limited to a

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more or less predetermined amount, as in certain types of partnerships and in the corporation.

Domestic and Foreign Organizations.—It is through these general statutes that the peculiar arrangement of our government that vests the states with residual powers makes itself felt. Any one of the forty-eight states of the union may adopt legislation creating new and untried types of entrepreneurial organization, vesting them with special powers and privileges which, again, might be denied them in adjacent states. Such organizations are accordingly spoken of as being *domestic* in the state under whose laws they were created, and as being *foreign* in all other states. Since the legal jurisdiction of any state does not extend beyond its own boundaries, it follows that all of the states have, in general, the power to limit or restrict as they please the activities of foreign business organizations of the type in question. They may even exclude them entirely from doing business within their jurisdiction, provided, of course, that they treat alike all foreign organizations, of a given class, and do not interfere with interstate business.

Greater Freedom of Common Law Organizations.—Generally speaking, the rights, powers, privileges and immunities of business organizations based upon common law are the same in all of the states, except in those cases where common law principles have been modified by statute. As a result of this general rule, it follows that business organizations based upon common law, as is quite generally the case with the individual proprietorship and the pure partnership, enjoy a relatively greater freedom of action than do those organizations that are created by statute.

Comparative Qualities of Entrepreneurial Organizations.—To enable one clearly to understand the legal distinctions that differentiate the types of entrepreneurial organizations from one another, some basis of comparison must be employed. In seeking such a basis of comparison,

we find that all entrepreneurial organizations have some qualities in common, but that they possess these qualities in varying degree of intensity. A brief discussion of each of these comparative qualities will make the distinctions clear.

(a) *Method of formation.*—Entrepreneurial organizations may be established either by the simple volition of a single individual, by contract between two or more individuals, or by state authority. An individual who has an idea, the necessary capital and the will to become an entrepreneur needs only to combine these, and to set up his establishment at his own pleasure. But, if he feels that the undertaking is too big for his own resources, and he desires to have others go into the venture with him as partners, the necessity for an agreement among them, as to the share of each in the business, becomes imperative. Such an agreement in the eyes of the law would be a contract which may be altered only by subsequent agreement of the parties thereto. If his proposed undertaking will require the combined resources of many individuals, he may find the contractual relationship among them impractical, which circumstance may lead to the adoption of an organization such as would obviate the need of such a binding contract as the partnership agreement. He would, in such a case, most likely adopt the corporate form of organization and issue securities. However, to do this, he must secure the proper authority from the state and proceed according to state law.

(b) *Liability of the entrepreneur.*—In business parlance, the term liability refers to the financial obligation assumed by the entrepreneur. It is held to be *unlimited* when the creditors of the business have the lawful right, through proper court procedure, in case of the insolvency of the entrepreneur, to apply all² of his real and personal

² There are always certain exemptions under federal and state laws.

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property toward the satisfaction of their claims against him or his business. In former times, when an entrepreneur went into bankruptcy, all of his property could be seized by his creditors, and he, himself, should his property be insufficient to pay his creditors in full, could be thrown into prison until all of his debts had been paid. Under modern practice, however, the entrepreneur is discharged from any further obligation on surrendering all of his property, unless there is evidence of deceit or fraud. The modern theory thus places upon the lender, as well as upon the borrower, the risk of credit transactions. The curtailment of the power of the creditor over the debtor has been carried still further by laws providing for *limited liability* of entrepreneurs under certain types of organization, such as the corporation and the limited partnership, whereby the creditor may look ordinarily only to assets of the business, as distinct from the other property of the entrepreneur, for the satisfaction of debts. Limited liability is only assuredly procurable through authorization by the state, which then protects the creditor, in part, by giving public notice of any grant of limited liability.

(c) *Ease with which the required capital may be procured.*—Statistics indicating the rapid and steady increase of the capital requirements of the average manufacturing establishment, showed, in 1914, that this had reached the sum of \$76,952. This amount is considerably in excess of what the average business man has at his command, either in funds that he himself owns, or that he may borrow. Moreover, even if an entrepreneur were fortunate enough to launch an average manufacturing establishment without outside assistance, it is yet questionable whether he would find it advisable to adopt a form of organization that would involve him in unlimited liability, when it is relatively easy for him to limit it. The question of busi-

ness expansion, also, is important in this connection. If all owned and borrowed funds that can be procured under the unlimited liability types of organization are already in use, it will be very difficult to secure additional funds for the purpose of expansion. For an individual is not likely to assume a share of the entrepreneurial function in such an enterprise, when by so doing, he assumes, irrespective of his associates in the business, the full legal responsibility not only for all the standing debts, but also for the debts that may in future be incurred. For this reason, the number of individuals who can be taken into such an organization as entrepreneurs is relatively small, which fact in turn limits the supply of funds that may be drawn on. But if, on the other hand, it is a type of organization which limits the legal liability of the entrepreneur to that amount which he puts into the business, the chances of securing additional capital are thereby made much greater. Indeed, the limited liability form of securities-issuing organizations have on tap practically an inexhaustible supply of loanable funds to draw upon through the sale of securities, while the unlimited liability, and non-securities-issuing forms must very largely be content with such funds as the private fortunes of a few intimately acquainted persons might provide.

(d) *Durability and Stability*.—The quality of durability and stability is a criterion by which the possible span of life of an entrepreneurial organization may be judged. It is primarily concerned with those acts or conditions that, in the eyes of the law, will, *ipso facto*, break up the business unit. A little reflection enables us readily to classify them into two groups; namely, those that are voluntary, and those that are involuntary. In the first instance the dissolution of the organization is based upon the personal desire of the entrepreneur to dissociate himself from his business, while in the second, it results usually through the operation of law, regardless of the desire of the entrepreneur.

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The ease with which the voluntary decision of an individual to discontinue his entrepreneurial relationship to a given business enterprise can be carried into effect, depends upon the legal nature of the act creating the organization. If it has been created by simple voluntary act on the part of a single individual, it may be dissolved in the same way, for example, by the sale or discontinuance of the business by the individual entrepreneur. Where the organization has been established by a contractual relationship between several individuals, this freedom, on the part of the entrepreneur, to withdraw at will is much limited and restrained by legal bonds. The withdrawal of any one of the entrepreneurs in such cases constitutes a breach of contract, unless withdrawal is provided for in the contract agreement, or acquiesced in by the other contracting parties. In either case, however, such an act is held at law to be an abrogation of the contract; the result of which is to extinguish the organization that the contract brought into being.

In the case of those organizations that employ the security form of capital, voluntary dissolution cannot be brought about by the withdrawal of any one of the entrepreneurs interested; for the relationship of the entrepreneur to such a business organization is purely impersonal. The business continues to exist intact, because the entrepreneur who retires cannot withdraw capital from it, but merely transfers his interest in it by divesting himself of title to its securities. To accomplish the voluntary dissolution of this type of organization requires a full compliance with the provisions of the grant of authority given by the state in the first instance, by virtue of which the organization was established. However difficult of accomplishment this may be, it nevertheless still leaves to the will and desire of the individual, the matter of the continuance or discontinuance of his entrepreneurial relationship to the business.

Voluntary dissolution of business organizations is, on the whole, not difficult to carry into effect. Under the individual proprietorship, no fixed procedure whatever need be followed; under the personal contract forms, a simple contract similar to that creating the organization may be employed, while under the securities-issuing types of organization, the procedure to be followed is clearly defined and prescribed by law.

Involuntary dissolution of the entrepreneurial organization may arise from three general causes, i. e., (1) from the death of the entrepreneur, (2) from operation of law and (3) from social revolution. Dissolution by death of the entrepreneur takes place only in the lower forms of organizations such as the individual proprietorship and the partnership, but can hardly be effected through that cause in the case of the corporation. For the latter type of organization is a child of the law, created as an entity in itself, with ordinarily a fixed, predetermined period of life. The existence of certain conditions within the business, as for example, insolvency, and also the commission of certain acts by the entrepreneur, that are either fraudulent in nature, in direct violation of law, or that impair the solvency of the business, will, by operation of law, force the organization into dissolution. Since, in the pure partnership, each partner has unlimited liability, it follows that the insolvency of any partner impairs the solvency of the business, and causes dissolution. In so far as social revolution is a force making for the dissolution of entrepreneurial organizations, it goes almost without saying, that any social upheaval that would result in the establishment of a different industrial system than that now in effect, would undoubtedly make an end of some of the present forms of business organization.

Summarizing, then, the various aspects of the quality of durability and stability, we find on the one hand, that

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voluntary dissolution becomes relatively more difficult as the complexity of the organization increases, being easiest to accomplish in the case of the individual proprietorship and most difficult in the case of the corporation; and, on the other hand, that involuntarily dissolution may arise most easily where the organization is based upon a personal contractual relationship, and is perhaps less likely to take place in those organizations that enjoy a definite period of life under grant of the state.

(e) *Ease of direction.* — Under our prevailing industrial system, the activities of any business unit must be directed and administered primarily with the aim and purpose in view of returning a profit to the entrepreneur. This function presents a host of problems for whose solution the responsibility ultimately rests upon the entrepreneur himself; for he is, as it were, the court of last appeal in all matters affecting his business. We find him thus, either directly or indirectly, confronted by the financial policy, the question of expansion or contraction of the business, the necessity of adopting a suitable form of administrative organization, the selection and institution of a policy to govern the industrial relations between the management and its employees, the technical problems of production, buying and selling methods, and a great many others equally as vexatious and difficult. The degree of success or failure with which these problems are met and solved will serve also as a scale by which to measure the efficiency of the directive force behind the enterprise.

Directness of control. — The legal responsibility for the direction of the business rests upon the entrepreneur. This circumstance leads easily to the argument that a direct control on the part of the entrepreneur is the most desirable. But under the several distinct forms of organization recognized by law, this direct contact cannot always be maintained. In the individual proprietorship and the part-

nership forms, the full responsibility for the direction and management of the business is usually assumed by the entrepreneur. This is more or less inherent in these forms; although in the latter type, through contractual agreement, one or more of the partners may limit their right of direction to the extent of actually withdrawing from any active participation in the affairs of the business, thus becoming, as it were, "silent partners." Moreover, what in the lower forms of organization, is a conscious, voluntary limitation of the power of direction on the part of the individual entrepreneur, becomes, in the more complex forms, an unavoidable requirement of the law. Thus, in the corporation, we find the entrepreneurs, who are the stockholders, directing the affairs of their business, with but few exceptions, through the medium of a board of directors chosen by them for that purpose. Such an arrangement can have but one result. It leads inevitably to lack of interest on the part of the entrepreneur in his business. But, where the number of entrepreneurs engaged in a single business is very large, it would seem to be almost impossible to direct the undertaking without introducing some such directive body into the organization.

Secrecy. — However, the relative efficiency of the directive machinery of the several types of entrepreneurial organization is not to be measured solely by directness of control. There are other factors that also must be considered. Thus, secrecy, where it is essential to the business, is more easily maintained if there is but a single entrepreneur, or at most, if the number is small. The chance of disclosure of secret processes naturally tends to increase proportionately with the number of persons entrusted with their safekeeping. But even very large organizations have been known to keep secret important formulae and processes in the face of concerted efforts on the part of competitors to discover them. This feature has been one of

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the marked characteristics of the German chemical and dye-stuff industries. Nevertheless, the simpler types of organization seem to offer some little advantage to the entrepreneur in this respect.

Centralization. — Another aspect of the question of efficiency of the organization for purposes of direction, is presented by consideration of the quickness with which action may be taken. Here again, the advantage lies with the simpler forms, due to the possibility of greater concentration of authority under them. The position of the entrepreneurs in the several types of organization in this particular may well be compared with the absolute monarchy, the pure democracy with full power to act vested in each member, and the representative democracy which may act only through its duly elected representatives. The individual entrepreneur, as the absolute monarch, may act while the others are considering the matter. The partnership like the pure democracy, would find much difficulty in adopting a plan of procedure if the constituency is very large. The entrepreneurs of the corporation, like the citizens of the representative democracy, have given up some of their directive powers for the sake of securing promptness of action.

Specialization. — Promptness of action, however, is not secured without some sacrifice. Nearly all of the problems of direction that confront the entrepreneur require that the one entrusted with their solution and direction have some special knowledge, or skill, in each special field. In case the business is a large one, administrators well versed in the principles of business finance, in marketing methods, in the technique of production and in the legal aspects of the business, are essential. What could be more desirable than to attach such experts to the business by means of the entrepreneurial bond, thus giving them a keener personal, as well as financial, interest by making them part owners

of the business? This, then, is a question of hired as against associated assistants. In the case of the individual proprietorship, it is obviously impossible to have associated assistants. Here, centralization of direction is secured at the sacrifice of specialization. The pure partnership permits of some specialization through association of partners, but exhibits a great lack of centralization. Only in the higher forms of organizations does a balance between the two exist. They afford the opportunity of giving the specialists the amount of freedom of action they would seem to require, while at the same time the possibility of over-specialization may in part be guarded against by giving the specialists a proprietary interest in the business.

The various aspects which the ease of direction of the several types of business organization presents, are such as the careful student of the problem of organization cannot well neglect to take into consideration.

(f) *Onerous obligations.*—No type of business organization leaves the entrepreneurs entirely free from certain onerous obligations. Some of the more important among obligations of this nature, are taxes and reports to the state and federal governments and to those who have a proprietary interest in the business. The simpler forms of organization are relatively free from these; but the higher forms, and more particularly the corporation, are heavily burdened with them. The necessity of requiring complete information concerning business establishments operating under limited liability to be recorded and filed where it will be available to those who have business relations with such concerns, is only too apparent. Their creditors must be advised of the limited liability of those with whom they do business. As the state takes upon itself the responsibility for granting limited liability to entrepreneurs, so also, does it assume the responsibility for keeping on hand detailed in-

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formation relative to such grants. These records are open to inspection by the public.

Because of the peculiar arrangement of our political system, any state may authorize a limited liability business organization which, however, may do business in other states only on sufferance of those states. Each state has the right and power of defining under what conditions the limited liability organizations of other states shall be permitted to do business within its boundaries; and in order to assure itself of full compliance with its laws, it requires the filing of detailed annual reports, and the payment of an annual license tax, as precautionary measures. It follows that organizations of this type, doing business in many states, may find themselves obliged to prepare and file with each of the several states annual reports on their financial condition, including assets, earnings, liabilities, etc., and to pay annually to each a franchise tax as a prerequisite to doing business.

In addition to requirements pertaining to reports and taxes, there are also, in the case of the higher forms of organization, certain other obligations such, for example, as prescribe a course of procedure that must be followed in directing the activities of the business, namely, in directors' meetings, stockholders' meetings, etc. These regulations are intended, not only to protect those that have a proprietary interest in the business, but also those who have extended credit to it. The onerous obligations imposed upon the business, are seen to exhibit great variation, dependent upon the type of entrepreneurial organization adopted by those who establish themselves in business.

(g) *Legal status*.—The legal status of the business organization also, is of considerable importance to the entrepreneur. The question that he must ask himself in this connection is "Will the business, as such, have a standing at law, and can it sue and be sued in its own name?"

It is held, where the organization has been established by simple contractual agreement among the entrepreneurs, such as is employed to form the partnership, that the resulting organization has, in itself, no standing at law that will enable it to sue or to be sued as an entity or person distinct from the persons of the partners.

(h) *Sphere of activity*. — Business organizations viewed from the standpoint of their legal sphere of activity, that is, the latitude that they enjoy of exploiting a field of business and of changing, extending or narrowing their operations, fall into two general classes: (1) those that are unlimited in their freedom of action and (2) those that are obliged to confine their operations to specific objects.

(1) The type of business organizations that enjoy unlimited freedom of action, may enter any field of business that is not specifically withdrawn from private enterprise, and that is otherwise lawful. Within these limits, they may shift from one type of enterprise to another, or expand and contract at will, or discontinue the undertaking at will without formal procedure of any kind and without specific sanction of the state. They have the same right and freedom of action, in this respect, as a natural person.

(2) Those that are limited, and must confine their activities to such objects as they have been specifically authorized to undertake and pursue, are such whose legal status is that of artificial persons, like the corporation. As artificial persons created by act of law, their powers and freedom of action are confined to those specifically granted in the act creating them. Thus, a corporation given authority to go into the paint manufacturing business, may not, of its own free will, go into the lumber business. If it chooses to do so, it must secure that authority from the same source from which it originally sprang.

The importance of this characteristic of ownership types,

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as well as others that have been considered in the preceding paragraphs, may easily be overemphasized. They are almost purely of legal significance and serve, not only as a means to measure and compare the efficacy of the several types of entrepreneurial organizations that are to be treated in this text, but also, in part, as a basis of classification.

Classification of Ownership Organizations.—A proper classification of entrepreneurial organizations must take cognizance, first, of the broad economic principles laid down in the first chapter and, second, of the legal characteristics peculiar to each type.

The first well-defined basis of classification rests upon the kind of capital directly employed in the business venture. From this standpoint, two groups are distinguishable, (1) operating organizations which own, direct and manage a business plant and equipment consisting of real and money capital, and (2) combination organizations that employ capital in business through the medium of operating organizations.

Next must be considered the intimacy with which the organization is attached to the life and financial soundness of the entrepreneur. A careful study of the legal characteristics of ownership organizations will lead, as in the preceding case, to a division into two well defined classes, (*a*) personal ownership organizations and (*b*) securities-issuing organizations. The former are those that the law does not distinguish from the person of the entrepreneur, and which are legally terminated and dissolved by the death or insolvency of any entrepreneur actively interested in them. They include the individual proprietorship, the participation association and the partnership. The other class includes those that continue to live as business organizations in the eyes of the law even though one or more of the entrepreneurs should

die or become bankrupts. The joint stock company, the corporation and the securities trust make up this class.

The classification of primary types may now be recapitulated in tabular form as follows:

Operating organizations:

a. Personal ownership

1. The individual proprietorship
2. Participation association
3. Partnership

b. Impersonal ownership (securities-issuing organizations):

4. The joint stock company
5. The corporation
6. The securities-issuing trust

PART II

PERSONAL OWNERSHIP ORGANIZATIONS

CHAPTER III

THE INDIVIDUAL PROPRIETORSHIP AND THE PARTICIPATION ASSOCIATION

Personal Ownership Types. — The personal ownership types of entrepreneurial organizations include the individual proprietorship, the participation association, the partnership and the simple trust. Historically, they may be traced back to the earliest period of history. They are as old, therefore, as civilized society itself. With the possible exception of the trust, they were well known to the ancient Egyptians, Greeks and Romans and particularly to the Phoenicians, who were the great commercial peoples of the ancient world. Through these many centuries they have come down to us with but slight if any modification, and as long as the institution of private property remains as one of the corner stones of our civilization, they will retain a place in the business world. But, as already indicated, the relative importance of these organizations for the conduct of business, has dwindled considerably during the past century. Nevertheless, their use today is still sufficiently extensive to warrant a careful consideration of their peculiar characteristics, their advantages and disadvantages as well as their general serviceability as ownership organizations.

The Individual Proprietorship. — The individual proprietorship is a form of entrepreneurial organization in which the business is under the sole ownership, control and direction of a single entrepreneur who has risked his private fortune in the undertaking. It is the simplest form of

ownership organization. By reference to page 89 it will be shown to form the great bulk of the number of business establishments in this country, although from the standpoint of magnitude, based upon the number of wage earners employed and the value of product or amount of business done, its importance in the business field is relatively much reduced. The numerical preponderance of this type is accounted for by its simplicity of organization and direction, and by the ease with which it may be formed, changed or discontinued, as well as by the circumstance that the average amount of capital required in the vast majority of business undertakings, particularly in the commercial field, is comparatively small.

Characteristics. — The chief characteristics of the individual proprietorship have already been somewhat indicated in the preceding chapter. The legal rights, powers, obligations and limitations of this type are in general identical with those enjoyed by the person of the proprietor. The law does not recognize the individual proprietorship as distinct from the proprietor. In the conduct of his business, therefore, he need but conform to the general rules of civil right. To go into detail concerning these rules, is without the pale of this text, as it would lead into the subject of civil law. A few brief paragraphs will suffice to bring out the more conspicuous features of this type, as well as its general limitations.

Formation. — Anyone who has sufficient capital of his own, or the capacity to borrow it, can easily launch a business enterprise as an individual proprietor. All that he needs is an idea, the will and a sufficient command over capital to establish himself in business. There are no binding contracts limiting his freedom of action; no special authority from the state is required, and he need consult no one. So long as he complies with the general provisions of the law, he may conduct his business freely and un-

molested, either making for himself a profit or sustaining a loss. The process of formation is simply a matter of will, coupled with a capacity for its effective execution. In so far then, as the element of formation is concerned, there could be no greater advantage than that enjoyed under the individual proprietorship.

Durability. — Since the law does not recognize a business conducted as an individual proprietorship as a legal entity distinct and apart from the person of the proprietor, it follows that the life limit of the proprietorship is coterminous with that of the proprietor. By will or testament it is possible for the proprietor to transmit his business as a going concern to his heirs. Such an act, however, does not serve to continue the original organization in the eyes of the law, although the business might continue active as a factor in the industrial world. It would be looked upon as under the ownership, control and direction of a new entrepreneurial organization. During his life the proprietor is free at any time voluntarily to withdraw from business, either discontinuing it in part, or in its entirety, or by gift or sale to another. Only by due process of law may the business organization be terminated against the proprietor's will. Should the state require the property involved for some public purpose, it may be taken from the owner by right of eminent domain on tender of its fair market value by the state. Or should the business become a public nuisance, or otherwise injurious to the public welfare, the proprietor might also be forced to terminate his business by a decision of the proper courts. Also, if he should be legally adjudged insane, or legally incompetent, the courts would deprive him of the conduct of his business and place in his stead a trustee or administrator, who, for all business purposes, would then become the proprietor.

Liability. — The liability that the individual proprietor assumes is unlimited. In case of failure of the business

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the creditors can look to all of the proprietor's property, whether employed in the business or not, for the satisfaction of their claims. Not only the assets of his business, but also his real estate, his home and all of his personal property, with the exception of certain small exemptions provided for under the federal and state bankruptcy laws, may be sold to meet his business debts. He stakes all upon the chance of success or failure of the undertaking.

The only compensating feature in connection with this unlimited liability lies in the relatively greater credit possibilities. The borrowing capacity of the individual proprietor is not so narrowly measured by his business assets, but rather by the sum total of all of his property. Capital, however, is not the only measure of a man's command over credit. His personal character and business ability are even more weighty determinants. But even when measured by these qualities, the credit advantage of the individual proprietorship type of organization is clearly recognized. But, on the other hand, some types of entrepreneurial organization afford an opportunity to limit the liability of an owner to a definite amount, thus diminishing the risk of loss. As long as this is not possible under the individual proprietorship, we may consider its unlimited liability as a distinct disadvantage from the business man's point of view.

Direction and Control.—The power of direction and control in the individual proprietorship is vested solely in the person of the proprietor. In this particular he resembles closely the ruler of an absolute monarchy. This feature has its advantages, as well as its disadvantages. On the one hand, it presents a high degree of centralization of authority and responsibility in the proprietor. It enables him to act promptly in all business matters, to take immediate advantage of fluctuations in market conditions or of unanticipated opportunities that must be seized

upon without a moment's loss of time. It is often just such things as these, that throw the weight in favor of success, when hesitancy or delay, such as is frequently unavoidable in associative organizations, might mean loss and at times even complete ruin. On the other hand, this indivisible ownership, coupled with an inherent singleness of control, tends to make it difficult to secure the full and hearty cooperation of assistants in the prosecution of the venture. In a small business, this is not such an important matter, for few assistants would be needed. But if the business is large, it will require the services of specialists in the field of purchasing, sales, manufacture, etc., according to its nature. To be sure, the proprietor can readily hire such specialists to help him in the management, but he cannot give them a true share in the business without destroying the individual proprietorship organization. This circumstance tends to make it more difficult to secure their full cooperation toward the successful conduct of the business, in so far as it does not permit of the use of the entrepreneurial incentive to tie them to the undertaking. This disadvantage may be overcome, in a measure, by the introduction of some system of profit sharing to add to the incentive of the employee. Such schemes, however, are merely palliatives, in that they are useful only so long as the business makes a more or less regular profit, and they become worse than useless when profits fail.

Capital Limitations. — The statistics of manufactures, given in a following chapter,¹ show clearly a very rapid growth in the size of the average manufacturing establishment. They indicate also a steady decline, in recent years, in the size and importance of such establishments operated under the individual proprietorship type of ownership organization. Among others, one reason for this — and by no means one of minor importance — is the fact that

¹ Chapter V, page 89.

the capital requirements of the typical manufacturing establishment have grown to such magnitude as to be almost entirely out of reach of the average individual. By 1914 it had reached \$76,982, a sum such as a proprietor would find it quite difficult to procure in investable form, even though he added to his available capital such funds as he might be able to borrow. Furthermore, why should he take upon himself the risk of putting all of his capital into a single undertaking, when it is possible to participate in numerous undertakings operated under security-issuing organizations? Also, money capital, once transformed into real capital in the form of manufacturing plant and equipment and commercial wares, besides being subject to continual depreciation, is not again quickly reconverted into available money capital without some risk of loss. This risk is naturally much greater where money has been invested in a manufacturing plant, than where it is in merchandise. But if the same funds are applied to business purposes through the medium of security-issuing organizations, the reversion into money capital is quite generally assured through sale of the securities to others. These considerations make clear the limitations attendant upon the individual proprietorship. Therein lies, also, the reason for its decline in importance.

Evaluation.—By and large, the individual proprietorship is primarily an organization adapted to small enterprises, where close personal supervision is possible. Enterprises that require a comparatively large fixed investment, like manufacturing, because of the relatively greater risk involved due to the difficulty encountered in reconvertng such investment into money, are, as a rule, not desirable undertakings under this form. Mercantile establishments, with their relatively more liquid assets, still afford an excellent field for the proprietor. Retailing may be conducted on a small scale, as well as on a large one, ranging

from the cross roads country store to the large department store of the city. The extensiveness of the business can be readily adapted to the capital that the prospective proprietor has available for investment. The business can be expanded as the capital grows. The profits, small though they may be, can easily be put back into the enterprise. This is not so easy in manufacturing undertakings, which often require duplication of much of the original equipment in order to increase the output. The growing size of manufacturing establishments, consequently, acts to exclude the individual proprietorship more and more from that field of mercantile enterprise where it is still by far the most important type of entrepreneurial organization.

The Participation Association. — Association of one or more individuals for the undertaking of business ventures is found to have been rather common among some ancient peoples. For the purpose of lightening somewhat the excessive burden of risk inherent in the maritime commercial ventures of those days, there sprang up a type of business ownership organization, whereby several men who possessed spare funds could invest them without the excessive risk of loss attendant upon the individual proprietorship. A merchant, not wishing to risk all of his capital in fitting a ship and supplying a cargo for some foreign port, would enter into an agreement with others, under which the latter agreed to supply capital in money or wares, being liable only for the amount contributed, and foregoing any right in the management and direction of the undertaking. The merchant thus became a *commandatary*, and the contributors his co-participants in the venture, to share in the profits or losses according to the terms of the agreement. The business was then conducted by the *commandatary* as if it were an individual proprietorship.

Toward the latter days of the empire, the Romans also

began to avail themselves of this type of organization. But it was not until after the fall of the Roman Empire and the rise of the power of the Church, that association for business purposes received its real impetus. The canons of the church forbade taking interest on loans. As a result of this ban, those who possessed spare funds were hard put to it to derive an income from them. To do so, it was necessary to participate in business. Under these conditions, there arose, during the eleventh century in Italy — where the revival of commerce first made its appearance — a type of business association called “*commenda*” or “*acommanda*.” This *commenda* was formed by secret agreement between the *commandatary* who was to conduct the business — usually a single venture — and one or more participants who furnished only funds or goods, and risked no more than their original contributions. In its dealings with third parties it operated as an individual proprietorship. On completion of the undertaking the profits, if any, were divided ratably on the basis of contributions or upon some plan agreed upon, and the association was automatically dissolved.

The further development of this type of organization, followed two general courses. On the one hand, it lost its temporary character and came to be used to conduct more or less permanent business establishments, developing later into a sort of partnership of the type employed by the great Italian banking firms of the Peruzzi and the de Medici families. On the other hand, its temporary character, as well as the element of secret participation, became emphasized; and it developed into the “*participatio*” which, with minor modifications, is the model upon which is patterned that class of organizations, which for lack of a better name, and in order to avoid technical inexactitudes, we shall designate by the general term *participation associations*. From Italy, this type of organization spread

gradually throughout all Europe, where, during the middle ages, it appears to have been one of the chief vehicles of commerce. Today, it still is of sufficient importance to have several sections of the commercial codes of continental European and Latin countries devoted to it.

Definition and Nature. — A participation association is a business organization, arising out of a secret contractual agreement between two or more natural persons, for the purpose of undertaking and concluding one or more single isolated business transactions, under such form and conditions, and with such division of interest, as may be agreed upon by the participants.² In Italy it is today called *associazione in partecipazione*, in France *société en participation* and in Germany *Gelegenheitsgesellschaft*. There is no exact counterpart for these organizations under English law. In the United States and the United Kingdom the limited partnership with a dormant or sleeping partner and the joint adventure, when applied to single ventures, most nearly resemble it. For the most part under English law this type is treated as if it were a partnership.³

The true test of the existence of a participation association lies in the requirement that its existence be unknown to those with whom business is done. The existence of the agreement, as well as the terms thereof, must be known only to the participants; otherwise, it at once becomes a partnership. The object or business purpose of the association, arises at the moment in which the parties make their agreement, and does not endure beyond the

² Article 48 of the French Commercial Code says "Ces associations sont relative a une ou plusieurs operations de commerce, elles ont lieu pour les objects, dans la forme, avec les proportions d'intéret et aux conditions convenues entre les participants."

Article 266 of the German Commercial Code defines it as "die Vereinigung zu einzelnen Handelsgeschäften für gemeinschaftliche Rechnung."

³ For these types see the following section on the partnership, pp. 63 and 69.

time necessary to accomplish it. Thus, two men attending a horse sale, agree between themselves to purchase a certain horse. One contributes his share of the purchase price as agreed upon, and the other, thereupon, negotiates the purchase. As long as the relationship arising out of the agreement between the two is unknown, the existence of a business association cannot be proven. The English common law places the burden of proof of the existence of a partnership upon him who relies upon its existence, and consequently, it does not differentiate between this type and the partnership. In cases brought before the French *courts of cassation*, it has been held that the exploitation of a mine, the operation of a commission house, and furnishing of military supplies were, in the particular cases cited, held to be valid objects for participation associations.⁴ They must be carefully distinguished from contracts, which closely resemble them, such as contracts for the extension of loans of capital, or of services containing provisions entitling the lender to participate in the benefits. They are also frequently confused with underwriting syndicates, which fall more properly into the class of partnership, in that the identity of those interested in them, is usually known to the person on whose behalf they undertake the marketing of securities.⁵

Property and Liability. — The property of the participation association, consists of such tangible and intangible assets, as all participants agree to contribute. It may include even commercial credit, provided that it is contributed by the managing participant, in whom ownership of all property is held to be vested. At law all increase or loss in the value of the property, and even the profits, belong to him. On completion of the object for which the

⁴ Juliu — C. Valcanescou, *Des sociétés commercial en participation*. Paris, 1916. Pp. 27-28.

⁵ For a description of underwriting syndicates see the following section on the partnership, page 69.

association is formed, he is, of course, obliged to share the profits with the participating members, as contemplated in the agreement. As a corollary to this concept of ownership of property, it follows, that the managing participant assumes full and final liability for any debts or obligations that he may have incurred, while the other participants risk only what they have contributed.

Management and Direction.—The management and direction of operations is in the hands of the managing participant. There may be several such, as in cases where goods are bought under a participation agreement and are allotted to the several participants, who thereupon separate and go into different parts of the community or country to sell their allotments, in accordance with the terms of agreement. Each thus has full management and direction of his assigned share in the execution of the contract as though he were an individual proprietor. The principal obligation of the managing participant is to render account of all transactions concluded under the terms of the agreement to his co-participants. Toward third parties, his obligations and rights are the same as those of the individual proprietor.

Legal Status.—This form of business organization enjoys neither a legal nor a commercial entity. Suit of any kind, must be brought against the managing participant as an individual person, and if suit is to be brought on behalf of the association, it must be by him, in his own name only. The reason for this lies in the nature of the association agreement, which is secret, and does not contemplate any act which would in any way place an obligation upon any participant, other than the manager, toward third parties.

As distinct from other forms of business association, this form has no social entity or right. An individual proprietorship is known by the name of the proprietor; a partnership, by the names of the partners, or by the firm name;

and a corporation by its adopted name. They are business establishments, and as such have a social, even if not a legal, being. But the participation association has no name known to the business world, by which it may be identified.

Dissolution. — The participation association may be dissolved by such causes, both voluntary and involuntary, as would have the same effect upon other organizations. Dissolution through bankruptcy, however, is somewhat restricted. The association, as such, cannot go into bankruptcy because it is not a social entity; but the voluntary or involuntary bankruptcy of the managing participant may ensue if he cannot meet his obligations, in which case the association terminates. In any event, the pressure forcing bankruptcy, must come from without the organization. The co-participants have no power or right under law, to force bankruptcy upon the managing participant, or to demand the liquidation of the business.

Limitations and Uses. — It can be seen that the very nature of the participation association, makes it unsatisfactory as an ownership organization under which to conduct a permanent business establishment. But its advantages and serviceability in undertakings that have as their object a single transaction are equally obvious. It is particularly useful to those seeking to conceal their identity, but desiring to participate in ventures entailing a high degree of risk, and where success produces a large profit. The identity of such participants is not known; and moreover, the odium of speculation does not become associated with them when they participate in risky ventures. Of course, it in no way affords any protection to the managing participant, other than to relieve him of the liability that he would be obliged to assume if he undertook the venture alone and rounded out his capital requirements through loans. Its two chief uses, thus, are for conceal-

ment of identity of participants in speculative ventures, and to enable entrepreneurs with insufficient capital to undertake ventures in business as managing participants.

The extent to which use is made of this type of organization in modern business, cannot be ascertained. Doubtless it runs up into the hundreds of thousands daily. Most of these undertakings, to be sure, are small, but nevertheless, they must make up a substantial portion of the annual business of those countries that recognize the participation association as a type of entrepreneurial organization.

Significance. — This organization is important chiefly because it was the embryo out of which grew many of the modern forms of organization. It established the principle of contributions of capital from two or more persons for the purpose of engaging in a single business enterprise. The partnership with all of its modifications and the joint stock company may be traced back directly to it, while through these it has exercised a strong influence in shaping the general structure of the business corporation.

CHAPTER IV

THE PARTNERSHIP

THE ordinary partnership, or firm, is the simplest form of associative business organization that enjoys recognition in business circles as a unified and single establishment. As a modern business institution, its history may be traced back to the Italian *commenda* of the eleventh century. During the middle ages, it grew into the most important form of private business organization; and with slight modifications, was the form under which the great banks and big business of that period generally were conducted. It was later driven from its premier position by the need of securing greater quantities of capital for the conduct of the trading enterprises that sprang up following the period of discovery subsequent to 1492. It thus developed into the joint stock company. Today, it is no longer as important in the field of big business, but still continues to enjoy some favor as a form of organization for the conduct of small businesses.

Definition. — The partnership has been defined as “a relation existing, by virtue of a contract, express or implied, between persons carrying on a business owned in common, with a view of profit to be shared by them.”¹

At law, the partnership is simply a definite relation between certain persons, called partners. It is not a thing of itself, but merely a condition. Consequently it is not considered to be a single person at law, and all of its legal relations must be conducted and met by the individual partners.

¹ E. A. Gilmore, *Handbook on the Law of Partnership*, 1911, p. 1.

But very different is its standing in the business community. The multiplicity and individuality of the co-partners are lost sight of, or at least minimized in importance. What the law does not recognize as a legal person, the business community recognizes as an economic business unit, equally as capable, and in many respects much more capable, of becoming the vehicle for conducting a business enterprise than if the individuals who compose it acted each for himself. Business must be conducted in the name of the partnership.

Formation, — the contract. — Ordinarily, in this country, as in England, partnerships are formed by contractual agreement under common law rules between the parties affected. In most other countries, such common law rules have been codified and incorporated into commercial codes. The common law applies equally in all of the states² of the union; but in most of them the provisions relating to partnership agreements have been assembled and by legislative act issued as statutes. In addition to these statutes, many states have special statutes governing the formation and operation of limited, special and silent partnerships.

The contract, or articles of co-partnership, that creates the organization, must be a legally valid contract; that is, the contracting parties (in this case the several partners) must be legally competent; the subject matter of the contract, and the purpose of the partnership must be reasonably possible of accomplishment and also lawful, there must be a legal consideration and an observance of the proper formalities required by law. It is advisable, but not necessary, that the contract be reduced to writing.

Ordinarily, every mature person is legally competent to enter into a partnership agreement. Felons, infants and lunatics, however, are debarred. Married women are competent only in such states where the statutes have so modi-

² An exception should be noted in the case of Louisiana.

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fied the common law as to declare them capable of contracting in their own name. A similar rule applies to corporations and firms; that is to say, they may become parties to partnership agreements only where specifically authorized by statute. For the most part, however, the ordinary partnership is formed by natural, mature persons.

The consideration must be some obligation undertaken by the parties, which ordinarily they would not be obliged to assume. This, however, is a simple matter, for it has been generally accepted by the courts that a mutual agreement with respect to a common enterprise is sufficient consideration.

A partnership agreement to carry on an unlawful enterprise, such as is contrary to the laws of the land, or against the best interests of society, will not have the sanction of the courts; and the parties thereto would be denied the protection of the law.

The formalities required by law in this country are generally quite simple. In most states the filing of a copy of the articles of co-partnership, or some other evidence of the creation of the organization, is required, while in others no formality, whatever, is prescribed. In Europe, under the commercial codes it is a common practice to require all partnerships to give certain information concerning the nature of the business, the amount of capital, etc., and the name under which it is to operate to a government bureau which inserts this information in the official commercial register for the benefit of the public. The latter plan is by far preferable, because this register may be introduced as evidence of the existence of a partnership; whereas, in the United States the burden of proving the existence of a partnership rests upon him who relies upon its existence. Thus, if a person enters into a contract for the sale of goods to one who represents himself as purchasing for a firm and afterwards sues the partners on the con-

tract he must present evidence that a partnership really exists.

At what precise time a partnership is created is a question that has frequently come before the courts for decision. On this point it is now the generally accepted rule, that the mere act of signing a contract, or entering into a partnership agreement, does not of itself create the partnership. The partners must actually begin doing business in accordance with the terms of the contract. It is the legal intentions of the parties, clearly manifested by their acts, that determines whether a partnership exists, and not their secret intention. Thus, a single sale or purchase that would place a business obligation upon the partners would be sufficient.

When the contract is set to writing, as is usually the case when the partnership business is a large one or the partners are numerous, the document is commonly called *articles of co-partnership*. Such articles of co-partnership ordinarily contain clauses on the following matters:

(a) The names of the parties to the agreement.

(b) The name under which the firm is to do business.

(c) The amount and nature of the original contributions of capital, including real and personal property, money, etc., with which the partnership is to commence business, and the share thereof contributed by each partner.

(d) The extent to which each partner shall be permitted to participate in the profits and losses and in the direction and management of the enterprise, and whether or not all shall be actively engaged.

(e) Provisions relative to the distribution of assets in case of dissolution.

(f) Provisions governing dissolution and arrangements, if any, for the continuance of the business in case of withdrawal, death or bankruptcy of any partner.

(g) Frequently also a section prescribing the method of accounting and bookkeeping that is to be installed and maintained.

(h) Lastly, the signatures of the parties to the agreement.

Legal Nature and Legal Actions. — The partnership is not a legal entity, that is, it has no standing in law as a business unit and can neither sue nor be sued as a firm. The law recognizes only the contractual relationship between the persons directly parties thereto, but does not recognize such an agreement as in any way limiting the rights of others in their dealings with the individual partners. In so far, therefore, as non-partners are concerned their legal rights lie against the partners as individuals; and the partners themselves must exercise their legal rights as individual persons before the courts.

Since under the ordinary partnership agreement each partner becomes agent for the others in all business represented to be on behalf of the firm and generally within the scope of the business, it follows that a third person, not a member of the firm, may seek redress on any such contract not solely against the partner with whom he entered into the transaction, but also against any of the other partners. Consequently when suit is brought against the firm on a contract it may be brought against any partner or against all of them; but it cannot be brought against the firm in the firm's name. In practice such suits are commonly directed against the several partners individually and at the same time against all of them jointly. This applies also to other actions at law. In legal phraseology it is said that actions are by or against the partners "severally and jointly."

Rights and Obligations of Partners toward One Another. — The rights and obligations that ordinarily attach to partners are to participate:

(a) In the direction and management of the enterprise, and

(b) In its assets, profits and losses.

In case no special provision defining the rights and obligations of the several partners relative to the matters mentioned above is made in the contract creating the partnership, the common law rules or statutes, if any, are held to govern. But if any provision deviating from common law practice and permissible under statutes is contained in the contract, such provision is held to take precedence over the common law rules, as it is evidence of the intention of the parties on the point in question. The advisability of having the contract set to writing is at once apparent. Under a verbal contract disputes can arise which, with no evidence at hand to indicate just what the intention of the parties may have been, may easily lead to mutual distrust and final dissolution of the organization.

(a) *Participation in direction and management.*— Under the general partnership form of organization each partner has the right to participate in the management and direction of the enterprise, unless he agrees to forego it. Having this right, it then becomes a duty that he owes to his co-partners to take an active part in the business, contributing the best of his skill, his services and business acumen toward the success of the venture. But in exercising his right of management and direction he must constantly bear in mind that his decisions and acts, and particularly his business contracts with third parties do not bind himself alone, but also his co-partners. This wide latitude of freedom of contract accorded each partner under the law makes necessary not only a high standard of business morality coupled with mutual cooperation on the part of the partners, but also a healthy, mutual respect for the rights that each enjoys under the terms of the agreement.

To require a joint conduct of the business might easily result in serious difficulties. Even where there are but two partners, agreement is sometimes hard to secure. But where there are five or six the chances of disagreement are considerably multiplied, and were it made obligatory upon the partners to come to a unanimous decision, such a rule could serve no purpose other than to obstruct the firm in its business dealings. In order that difficulties such as these may be avoided as much as possible, it is the common law rule, where there are more than two members to an ordinary partnership, that the majority of such partners are empowered to carry a decision affecting the firm even though one or more dissent, unless the agreement requires a unanimous decision. In any case it is perhaps the better practice to appoint one or two of the partners as managers of the ordinary affairs of the business and to reserve general matters of policy for the consideration and substantial agreement of all. This, however, would not exclude the others from exercising their right of participation in the management and direction of the business unless it is so stipulated in the partnership agreement and has been generally accepted.

In case of gross mismanagement on the part of a partner resulting in loss or injury to the other partners, the courts may be appealed to to exclude the culpable partner from exercising his managerial powers. But this would be but a make-shift solution of such difficulties. The better practice in such cases is to arrive at some equitable basis for the withdrawal of the culpable member.

In all transactions on behalf of the firm each partner must always exercise his best judgment and employ as much care in his dealings as though he were working for himself alone. The law places upon him an obligation in the nature of a trust. If he violates this trust causing loss to the firm he can be required to make good such losses.

As agent of the other, each partner quite generally has the right and power to contract with outsiders on behalf of the firm and thus to bind his co-partners on the contract. But this right does not hold where the use of sealed instruments is required, nor generally where the transfer of real property or the fixed assets of the business is contemplated by one partner acting on his own authority.

Each partner is also held to be liable for defamatory statements of one partner, or for fraud committed by such partner in course of a business transaction for the firm, even though his co-partners have no knowledge of such act.

Each partner also has the right to inspect the books and accounts of the firm without restriction.

(b) *Right to participate in assets, profits and losses.*—The business capital of the partnership consists of the aggregate property in terms of money contributed by the several members to establish or to continue the business. A distinction should be noted between the capital and the partnership property. The latter includes the capital and real and personal property, patents, copyrights, etc., originally contributed or subsequently acquired and not yet distributed among the several partners. The contract determines what share of the capital each partner is to contribute. The law does not require that each member must make a capital contribution. While some may choose to do so, others may agree to contribute their services or skill in lieu of capital. The manner of making capital contributions is governed by the ordinary provisions of law relating to transfers of real and personal property. In the case of transfer of real property a sealed instrument is usually required. Such real property cannot be held in the firm name but only in the names of the partners as individuals because it is necessary for a legal person to hold land or realty.

Title to the property, with the exception of real estate, is vested in the partners jointly. Each partner's share entitles him simply to a given portion of what remains after all of the firm's debts have been paid. The extent to which he is to share in the property on dissolution is usually based on his original capital contribution and should appear on the books of the firm. He is not entitled to a partition or division of the property in kind. Division in kind is indeed sometimes quite impossible, as where one partner of a firm that owns a single ship withdraws. He could quite obviously not be permitted to take away part of a ship, but must be content with money or such detachable property as all might agree upon. Only upon final dissolution of the firm does a partner receive the full amount of his share in the assets, either with his ratable share of profit added on or with the losses deducted.

No partner may withdraw from the partnership his share of the property or assets, nor may he speculate with the firm's property nor mortgage its real estate or generally sell its property not ordinarily held for sale without the consent of the other partners. The same rule applies also to creditors; they may not withdraw any particular share of the property to satisfy their claim. Upon dissolution of the partnership, however, each partner is held to have power to sell the assets in order to wind up the affairs of the firm.

Sale of the vendible property of the business, that is to say of such property as is held and offered for sale by the firm, may be effected by any or all of the partners or by someone authorized to represent them. The non-vendible property, including real estate, and the more permanent business assets requires the common agreement of all partners for its disposal either in whole or in part or for the sale of such share as one or more partners may have in the firm. But in no case may even all of the partners

agree to dispose of the firm's property in such a way as to hinder, delay or defraud the creditors of the firm.

Each partner's share in the profits and losses may be fixed by the terms of the agreement. In so far as the partners themselves are concerned these terms would govern, but this does not work to limit the liability assumed by each partner for credit extended by third parties. In other words, the terms of the agreement place no restriction upon the obligation of co-partners toward third parties.

Obligations of Partners toward Third Parties.—It is particularly in the obligation of the partners toward third parties and in the rights of such third parties against the partners and the business that the peculiar character of the partnership form of entrepreneurial organization is most clearly brought out.

With the beginning of business relations with outside parties the partnership becomes, for all legal and commercial purposes an established business organization. We have seen that by virtue of law each partner is the agent of the others in all transactions undertaken by him with third parties, if such transactions are on behalf of the firm, and that the burden of proof of the existence of a partnership rests upon him who relies upon its existence. A third party, therefore, is not required by law to prove the existence of a partnership in order to recover on a contract entered into with one of the partners, for he may hold him responsible as an individual acting on his own behalf; but if he desires to hold each partner responsible as principal of the one acting as agent, he must be able to prove the existence of the partnership. The importance of this distinction is clearly brought out by a consideration of partnership liability.

(a) *Liability of partners for debts.*—To third parties, on all contracts entered into on behalf of the firm, the part-

ners are liable jointly and severally. Every debt that is incurred on behalf of the partnership is at the same time the debt of all jointly and of each privately, encumbering not only the assets directly employed in the business, but, if these do not suffice, also the private fortunes of the several partners.

This liability attaching to each partner individually, follows him even though he has withdrawn from the firm. If the creditor is actually given notice of the withdrawal of a partner upon a certain date, he may hold that partner liable only on contracts entered into prior to his withdrawal, until such time when all of his claims have been satisfied. If, however, the partner withdraws without giving actual notice to the creditor, the latter may still hold the former liable on contracts entered into on behalf of the firm during such period of time as he remained ignorant of the partner's withdrawal.

(b) *Creditor's satisfaction.*—Every creditor may choose how he shall satisfy his claims. He may sue either as a creditor of the firm, or as a creditor of a partner. If he sues as creditor of the firm, suing the partners jointly he can recover, ordinarily, only to the amount of the partnership's assets; whereas, if he sues as creditor of each partner, suing them severally, he can recover not only out of the assets of the business, but if they are insufficient to satisfy his judgment, also out of the private fortunes of the individual partners. Suits by creditors against partners are usually brought against them jointly and severally. A judgment secured in this way would first exhaust the assets directly employed in the business before it would draw upon the partners' private fortunes.

(c) *Alteration of the partnership agreement.*—Since the partnership is the result of a contract between the several partners, it follows that the partners may by common consent change that relationship at will. In so doing, how-

ever, they must guard against adopting alteration that will affect adversely the rights of third parties. The right of creditors in case of the withdrawal of a partner has already been discussed. It has also been pointed out that the partners may not dispose of the partnership property without first satisfying the creditors. Substitution of one partner by another person may also be effected, provided the interests of the third parties are safeguarded. And even in case of dissolution and discontinuance of the business must proper care be taken to protect the rights of the firm's creditors.

Classification of Partners.—Partners are commonly classified on the basis of some special advantage or obligation that is extended them under the partnership agreement into general, special, ostensible, secret, silent, or dormant partners.

General partners are such as have unlimited liability and full voice in the management and direction of the enterprise.

Special partners are those whose liability for debts of the firm has been limited. Creditors must usually be advised what partners are special and to what extent they enjoy limited liability.

Ostensible partners are such whose connection with the firm is openly avowed and relied upon by creditors, although they are parties to the agreement by inference only. They may be held liable by creditors if they do not specifically deny having any connection with the firm.

Secret partners are those whose connection with the firm is concealed or at least not made public. They are usually also silent.

Silent partners have no voice in the management but share in the profits and losses.

Dormant partners (also called "sleeping") are those in whom the characteristics of secret and silent partners are

combined. Under English jurisprudence, a partnership with one general and one or more dormant partners, forms the type of business organization resembling most closely the participation associations described in the preceding section. Dormant, as also secret and ostensible partners, are not very common.

Sphere of Activity. — As the partnership rests at bottom upon the principles of common law which are of general applicability in the United States, the members of any such partnership will enjoy generally the same privileges and obligations in any of the several states, except where certain statutory provisions may have made minor changes. Under common law the partners also are by no means restricted from extending or contracting their sphere of activity, provided that they confine their business to a lawful enterprise. By the mere formality of changing the terms of the agreement they may widen or narrow the purpose of their business enterprise, or change its nature completely, always, of course, exercising due care to protect the interests of their creditors.

Dissolution or Termination of the Partnership. — Voluntary dissolution of the partnership may be effected by mutual consent of the partners under the terms of the agreement creating it and under the conditions outlined in the preceding paragraph. The withdrawal of one or more partners is held to terminate the agreement but need not necessarily work to effect a general liquidation and discontinuance of the enterprise. Provision may be made in the agreement for such contingencies, which will preserve the commercial entity of the business; but if no such provision is made, the withdrawing partners can insist upon liquidation of the assets.

Dissolution by operation of law ordinarily results from the following causes:

- (a) Death or withdrawal of a partner

- (b) Bankruptcy of a partner or of the firm
- (c) Marriage of a female partner
- (d) Where the business has become illegal
- (e) Alteration of the firm's property or interest
- (f) Declaration of war between countries when the subjects of each are members of the firm.

In brief, any act or event that goes to the essence of the contract creating the partnership, is held to work its dissolution. But here also, as in the preceding case, provision may often be made for the continuance of the business under a revised agreement. In either case, however, the original partnership would be dead; revision of the agreement resulting merely in the creation of a new partnership.

In addition to the two methods of dissolution given, it frequently happens that the courts are appealed to to terminate the partnership relation by decree or annulment, as for example where there is a practical impossibility of success, an incapacity of the parties or a gross misconduct on the part of a partner.

Termination of the partnership, naturally, entails a general winding up of the firm's affairs. Creditors must be satisfied and the rest of the assets distributed among the partners according to the terms of this agreement. Under provision of law the satisfaction of claims against the partnership assets must take the following order:

- (a) Payment of all debts and obligations of third parties
- (b) Repayment of advances made by partners to the firm
- (c) Each partner's contributions of capital to the firm
- (d) Whatever surplus remains is distributed according to the partnership agreement.

Classification and Types of Partnerships.—Partnerships may be classified according to the nature of the business to be undertaken, the extent to which business operations shall be carried, and the nature of association.

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(a) *Nature of the business.*— Under this head partnerships fall into two general classes, trading and non-trading. A *trading* partnership is one in which the business transactions include the general dealing in commodities, as by buying and selling for profit. *Non-trading* partnerships are those formed for the joint pursuit of some employment or occupation such as the practice of law or medicine. It is the former that have been under consideration in this chapter. The non-trading partnerships follow quite generally the principles laid down, but in many instances with minor variations.

(b) *Extent of operations.*— Under this head partnerships may be classed as universal, general or special. *Universal* partnerships are those in which the partners agree to combine all of their property, skill, labor, etc., of every description in the enterprise. They are practically never used. In the *general* partnership the partners agree to join in all transactions of a particular class of more or less permanency, such as a partnership in banking, or merchandising. They make up probably the great bulk of trading partnerships. *Special* partnerships are association agreements with respect to a single venture only, such as a single mercantile transaction or the charter of a vessel for a single trip. They are quite common, but because of their temporary nature are not recognized as established business enterprises, being rather in the nature of joint adventures on the one hand, and participation associations on the other.

(c) *Nature of association.*— This classification is based upon variations in the principles governing the liability of partners, power to transfer their interest, power of withdrawal and the like. Thus classified, we find ordinary partnerships, limited partnerships, partnership associations, joint stock companies, mining partnerships and sub-partnerships.

1. *Ordinary partnerships* are those in which the partners and third parties are governed by the principles laid down as general rules in the preceding paragraphs of this section. They rest upon the rules of common law and accepted practice. In the French commercial code they are called *sociétés en nom collectif* and in the German, *offene Handelsgesellschaft*.

2. *Limited partnerships* differ from the general type, heretofore described, in that the liability of one or more of the partners is limited to the sum of their original capital contributions, but at least one partner must be a general partner of unlimited liability. The general partner must be actively engaged in the management and direction of the business, but no such rule applies generally to the limited partners. This type is possible of adoption in the United States only where statutes make provision for it. In Louisiana, under the modified French code, they are quite common. While nearly all states make some provision for them they do not enjoy great popularity because of the relative ease with which a corporation may be formed. Ordinarily under the laws of these states neither the limited nor the general partners may freely transfer their interest in the business to another. The French code treats them under the name of *sociétés en commandite* and the German under *Kommanditgesellschaft*.

3. *Partnership associations*.—In Pennsylvania and Michigan the statutes provide for the organization of partnership associations. Under these laws all of the partners have limited liability, and the shares of interest are usually represented by stock certificates. These stock certificates, however, unlike securities, are not freely transferable. A person acquiring the same must first be elected to membership, before being entitled to full participation in the business. If he fails of election the remaining members are empowered to, and must purchase the share of the peti-

tioner, either at a price agreed upon, or in default of such agreement, at a price set by an appraiser appointed by the court. As a prerequisite to organization of partnership associations, the articles of association must be approved by the proper state official, and a franchise tax, similar to that required of a corporation, must be paid. The word "limited" must also appear in the name of the association. The term of life is usually limited to a period of twenty years with privilege of renewal. Although quite serviceable in the state authorizing them, they are unsatisfactory for business in other states because they may do business there only by sufferance and not by right, as a consequence of which the limited liability feature may not be recognized, and they must be treated as ordinary partnerships before the law. Because of their close resemblance to corporations they are frequently called quasi-corporations.

4. *Joint stock companies* are primarily partnerships whose capital is divided into freely transferable shares represented by stock certificates of the security type. They are reserved for further treatment under a following section devoted to securities-issuing organizations.

5. *Mining partnerships* are modified forms of the general partnership that have arisen out of customary practices that arose in the early mining districts for the exploitation of mining claims in common by two or more persons. There is usually no fixed agreement, the partners simply working in common and sharing equally in the profits. Substitution of partners may be effected at will, without dissolving the partnership. For this reason also, the death of any partner does not work the dissolution of the firm, provided there are more than two members.

6. *Sub-partnerships* arise where one partner enters into an agreement with a third person to share as partner in his part of the profits and losses of the original partnership. They are not very common.

7. *Joint adventures* are partnership organizations that have for their purpose the conduct and conclusion of a single business venture. The terms of the agreement determine the nature of the venture and the number, rights, obligations and privileges of the members. In all of these particulars they resemble very closely the participation association; but on the question of liability of members toward third parties they differ from it. The liability of co-adventurers is equal, and as to third parties is unlimited, being entirely independent of the amount advanced. Their duration is limited to such a period of time as is necessary to complete the contemplated transaction.

8. *Underwriting syndicates* are a type of partnership that have as their object a single undertaking, namely, of assuring to the issuing organization a market for a definite amount of securities, at a predetermined price per share. Their work is of a financial character, in so far as they confine their operations quite largely to the conversion of securities capital into money capital, and make their profit or loss out of such transactions. They render invaluable service to large corporations and combinations by assuring them of sufficient funds to carry through their proposed undertakings.³ Concerning the nature of the liability of members of such syndicates, one authority says: "The members of a syndicate would undoubtedly be held liable to third parties as partners if the enterprise became absolutely insolvent. As most syndicates are formed for financial investments or underwritings, and either involve no obligation in excess of the amounts contributed, or, if otherwise, have well-defined and well-understood liability as to the syndicate transactions, and as the members of such syndicates are usually men or concerns of wealth and standing, the question of partnership liability rarely arises.

³ A brief description of the procedure of the underwriting operation will be found in W. H. Lough's *Corporation Finance*.

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If there were any danger of such liability it could probably be avoided by organization under a trust with express exclusion or individual liability.”⁴

Extent of Use.—Although no reliable information is available to show the number of partnerships actively engaged in business in this country, nevertheless sufficient statistics have been published to indicate the relative importance of this type of ownership as a business vehicle, and also to show, in a general way, in what fields of business it is most frequently employed.

The great obstacle standing in the way of ascertaining the number of partnerships compared with other types of entrepreneurial organization, is the intangible character of those types, which in continental Europe would more properly be classed as participation associations, but here are at law, partnerships. The temporary character of these organizations, having as their object only a single business venture, makes enumeration impossible, except in such fields of enterprise as manufacturing, where a more permanent establishment is the rule. Figures published in the Statistical Abstract of the United States give the number of manufacturing establishments operated as partnerships at about 62,600 in 1899, 54,000 in 1909 and 51,000 in 1914. The percentage of all manufacturing establishments that these made up was 22.9 in 1899, 20.2 in 1909 and 18.2 in 1914. But the importance of the partnership in this industrial field is overemphasized when number alone is taken into account. The value of the product of the above manufacturing establishments conducted as partnerships was only 19.0 per cent in 1899, 10.6 per cent in 1909 and only about 8.2 per cent in 1914. A glance at the table (page 88) showing sources of income from three types of business organization for 1917 is also instructive. Only

⁴ Conyngton, Thos., *Corporate Organization and Management*, p. 519.

13.7 per cent of the total net income from individual business, from partnerships and from dividends of corporations is credited to partnerships. Considerable variation in the proportion of income from these three sources derived from partnerships is also shown. In the agricultural states it is relatively low, while in the industrial states it tends to be much higher. Thus, in Iowa it is 6.9 per cent while in New York it is 19.1 per cent.

Several conclusions may be drawn from these statistics. First, that the partnership form of ownership organization is rapidly losing its importance in business, and second, that there must be certain inherent and contributing causes for this decline.

Limitation of the Partnership. — Among the causes for the decline of the partnership are certain of its inherent characteristics such as the following:

- (a) Unlimited liability,
- (b) Numerous uncontrollable events that affect its dissolution,
- (c) Obstacles in the way of free transfer by partners of their interest in the business,
- (d) Difficulty of securing harmony and unity of purpose in management, and
- (e) Natural limitation on expansion because of limited source of capital.

The last mentioned characteristic was not of any great consequence until the period of big business set in. But with its advent came an ever increasing demand for capital to be used in expanding business enterprises in the financial, transportation, mining, trade and manufacturing fields. To meet such growing capital requirements demands great elasticity in the ownership organization. This the partnership does not possess, and in consequence, it gave way to the more flexible and more serviceable corporation.

But the partnership also has several desirable qualities which are very serviceable in business enterprise. Among these should be mentioned (a) the ease with which it may be formed, (b) absence of restrictions on its sphere of activity, thus permitting of change from one type of business to another or of expansion into other fields more or less at will, (c) relative freedom from state regulation and control, and (d) the promptness with which it can act. Through attempts to conserve the advantages and to avoid the limitations, various modifications of the partnership have from time to time been made. Out of such attempts arose the joint stock company, the partnership association and several of the types of limited partnership above described. Under these modified forms it has been possible to employ it to operate very large enterprises. Thus, the Carnegie Steel Company was at one time operated as a partnership and the great "Iron Master" is reported to have said that, while operating under this form his concern could play all around his competitors. Most of these modifications follow the principle of making the partnership more durable by eliminating most of the causes of dissolution, and by providing for greater latitude in the transferability of interest. But even with these alterations it still lacks much of attaining the serviceability of the corporation. A German example of this is reported by Robert Liefmann.⁵ It appears that many of the coal mines in the Ruhr district, early in the last century, were operated under a form of partnership called *Teilhaberschaft*, which is characterized by permanent duration and free transferability, either in whole or in part, of such interest as a shareholder might possess. Even as late as 1865, by the splitting up of the original shares through sale, inheritance and transfer, a single share in the ownership of this

⁵ R. Liefmann, *Beteiligungs und Finanzierungsgesellschaften*, Jena, 1913. Pp. 40, 41.

concern was represented by a fraction whose numerator consisted of 47 digits and the denominator of 48. Others with 35, 30, and 26 digits in the numerator are also mentioned. One can imagine the poor bookkeeper, as he sweats over the distribution of net earnings to the holders of such shares. Others, again, prohibited the splitting up of shares, but permitted unrestricted transfers. This plan also had its disadvantages; for, as the business grew the shares became more valuable. Single shares of this type are reported to have attained a money value of about \$14,000, which, of itself, would make it difficult to sell them.

After all, it appears that nothing short of a full use of securities as instruments of organization to represent the participants' interest in the business can provide an ownership form under which a modern large-scale business enterprise can be satisfactorily set up and operated. This the partnership does not offer. In fact, none of the personal ownership organizations is adaptable to big business undertakings; but for small enterprises in manufacture, trade, the professions, agriculture and finance they offer many advantages, and there they find their greatest usefulness.

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PART III

SECURITIES-ISSUING ORGANIZATIONS

CHAPTER V

THE NATURE OF SECURITIES

THE types of entrepreneurial or ownership organization thus far considered, all have one outstanding characteristic — they are inseparable from the person of the owner. Any person enjoying the relationship of owner, or entrepreneur, in any one of them can lay claim, either in whole or in part, to the assets of the business; and furthermore, he can withdraw, dispose of, or hypothecate his share at will at any time. But this fact should be noted: In withdrawing from the business, he spontaneously causes the dissolution of the organization. This must be so, because, at law, the ownership of the assets is vested directly in the person of the proprietor or partner, and the share thereof that he owns goes with him when he severs his connection with the business. Of course, he may agree to accept the money equivalent in lieu of the part of the business plant and equipment that belongs to him; but the fact that he has a legal right to withdraw his share of the assets of the business cannot be overlooked. The personal element in these organizations, therefore, is predominant. It is this characteristic that distinguishes them most clearly from the securities-issuing or impersonal types, represented by the corporation, the joint stock company, and the securities-issuing trust.

Theory of Impersonal Organization. — The theory of impersonal organization is more easily understood if we have clearly in mind the purpose that it seeks to accomplish. Let us assume, for example, that we have before us a small steel plant operating under a personal ownership organi-

zation of the partnership type. Legally this organization is a condition, an agreement between persons, and not a thing or an ownership unit. The several partners have merely agreed to combine their personally owned plants and equipment for a business purpose. One of them now desires to withdraw.

There are four ways by which this may be accomplished. In the first place, the withdrawing partner would probably make an offer to the remaining partners to buy his share. If they are in a position to accept such an offer and act upon it, the result of the transaction would be to force them, perhaps unwillingly, to invest more capital in the business than they had originally contemplated. If, however, they do not have available sufficient funds to buy him out, he may adopt the second plan, namely, to sell his share in the business to a third person. This places upon him the burden of finding a buyer who is willing to take his place in the partnership — by no means an easy task. It would require a complete survey of the plant and equipment to ascertain its condition and value, a careful inspection of the books and accounts to determine net assets, profits, etc., and the drafting of a bill of sale conveying personal property and perhaps also real estate — in all, a mass of laborious details not only time consuming but also costly. Upon the other partners would then fall the obligation of reconstituting the organization in order to take in the purchaser who may be a total stranger to them, and, in addition, might prove to be incompatible. If no one can be found to buy the share of the withdrawing partner, he may propose the third plan — that of actually taking away from partnership control such part of the physical property, cash and accounts as may be agreed upon. This course naturally destroys the ownership entity of the plant. If all parties decide to continue to operate, we then have two distinct business establishments, neither legally

dependent upon, nor in any wise controlled by the other, except in so far as may be dictated by economic expediency such as the necessity for maintaining the economic unity of the plant. Aside from the difficulty of arriving at an equitable basis for the division of the property, this method of withdrawal obviously has another equally serious drawback. If it so happens that one part of the plant cannot operate without the other, and each part is under the control and ownership of a separate and distinct business organization, the difficulties arising from an attempt to operate the plant under such conditions would doubtless prove insurmountable. There would, then, remain only one other course, namely, to liquidate the whole business, sell it intact, as a going concern, or piecemeal, at a great sacrifice. Thus, under such conditions, the partners might all be forced, willingly or unwillingly, to discontinue the business.

The rigidity of investments, particularly in enterprises of this character, is well indicated in the above example. Capital once put into a business plant and equipment, except under favorable conditions resulting from a phenomenal rise in prices, cannot again be fully recovered by the sale of the original equipment. That must be operated at a profit, which, over a period of years, will be sufficient to replace the equipment as it wears out. Otherwise it is an economic loss falling most heavily upon the individual who owns the plant. This rigidity is greatly magnified by the many obstacles that stand in the way of the free sale and transfer by an owner of his interest in such an establishment, wherever it is operated under the personal ownership type of organization. It is also to be noted that these difficulties grow steadily greater with the size of the establishment. While one may find ten buyers for a share in a small business, considerable difficulty might be encountered in finding one, if it is a large business. Thus, the number

of persons who might be looked to as possible investors in personally owned establishments, is ordinarily quite small. They can draw their funds at best, from perhaps a score of persons who must be more or less closely acquainted, but the gateways that tap the vast reservoir of national capital surplus, closely held by millions of persons, are uncompromisingly closed against them.

The purpose to be attained by the impersonal types of entrepreneurial organizations may, then, be said to be two-fold, first to facilitate the transferability of the ownership interest in business, and secondly, to make available to business enterprises the capital surplus of the world. The instruments that they employ to accomplish this purpose are *securities*.

Securities Are a Class of Commercial Paper.—The term “commercial paper” comprises all credit instruments, other than currency, that give the bona-fide holder a claim on capital. These instruments fall chiefly into three general classes, namely, (1) money paper, more commonly called negotiable instruments, which include checks, drafts and bills of exchange, notes and the like, (2) commodity paper, such as warehouse receipts, bills of lading, etc., and (3) investment paper, including mortgages, bonds, stock and trust certificates, etc. The distinction, as based upon economic principles, lies in the fact that the claim of a holder of money paper is a claim on a definite sum of money to be paid at a definite time, while that of the holder of investment paper is a direct claim upon the income from a definitely designated accumulation of capital, and a deferred claim upon such capital itself.

Money Paper.—The chief use of money paper is to facilitate the transfer of, and dealing in money, by effecting a great economy in the use of real money, in that it becomes, as it were, a substitute for the latter in most trade transactions. Checks, drafts and personal notes, etc.,

arose and developed under an industrial system whose outstanding characteristic was personal ownership of the business establishment. We find some forms of this type of instrument were in use long before the dawn of the Christian era in Phoenicia and Babylon. They are serviceable alike to any system of ownership organization that is based upon private property. But this should be noted: They do not influence, to any measurable degree, the distribution of income, and consequently they work no noticeable change in industrial organization, neither do they establish any new principle of organization of business ownership.

Commodity Paper. — This class of commercial paper represents merely the ownership interest in the wares of commerce that are stored in warehouses or are in course of transportation by a common carrier. They, in no way, are instruments of ownership organization.

Investment Paper. — Money paper, it is at once seen, represents in no way a claim upon the income of capital. This is primarily what distinguishes it from investment paper. Through the use of the latter it becomes possible so to construct an ownership organization in business, that those who have invested money in it may more or less freely withdraw from the undertaking without affecting the entity of the organization. The business itself, through the use of these instruments, can have an economic, as well as a legal entity, separate and apart from the person or persons who invest in it. In the more highly developed forms this principle may be carried so far that any owner, or investor, risks in the undertaking no more than what he agrees to contribute; and he is free at any time to transfer his share in the business to whomever he may see fit, regardless of whether this may please or displease other investors or owners in the same business. Also, if any man does not wish to risk all of his capital in a single enterprise,

he may purchase the investment paper of a number of business establishments, and by this means iron out the inequalities of return from the various enterprises in which he is interested, in such a way as to bring him a fairly well assured and dependable income, even though he may give no attention and devote no time, whatever, to the affairs of the undertakings in which he is financially interested. Investment paper, then, does influence the distribution of income, and it may effect a change in the ownership organization.

However, not all investment paper affords the same freedom and flexibility of organization above indicated. The impersonal status of the organization, may be made little short of absolute through the use of certain types of investment paper, while others will produce little appreciable change in the personal ownership of the organization. Some types of investment papers may be freely transferred, sold and traded in, with scarcely any formality attendant upon such transactions; while others require more formality and special bargaining on the price of each piece sold. Again, we find that certain kinds represent a share in the ownership of the enterprise, while others represent a creditor's interest in the business with the principal secured by its assets. The following table will aid in understanding the general classification of investment papers that will be employed in this text.

Investment paper	Classified as representing	
	(a) Ownership in the business	(b) Creditor's interest in the business
Classified as to transferability:		
1. Non-securities (restricted).....	Shares ¹	Mortgages
2. Securities (unrestricted).....	{ Stocks Trust certificates	{ Bonds Notes

¹ English practice reverses the order, considering stocks as non-securities.

Ownership Paper.—Each instrument of the ownership group represents a fractional part of the business. This may be expressed in terms of money, for instance, by arbitrarily assigning a fixed sum as the capital of the business for this purpose, and then making each share a fractional part of this sum; or no money value may be employed at all, in which case the capital is simply stated as so many shares. In other words, each instrument may give the holder a one-thousandth part of the ownership interest in the business without the assignment of a value to it, or it may give him a one-thousandth part of an ownership capital set at \$100,000, in which case each unit would have an assumed value of \$100. Such instruments, whether with or without an assigned value, entitle the holder to share in the net income of the business and usually to a voice in its control and direction and to a share in the assets in case of dissolution, and place upon him the ownership obligation of risk, or liability of loss which may or may not be limited. Another important characteristic of this group is their permanence. Ordinarily once having been issued they are not redeemable or revokable, but remain a standing obligation

against the business as long as the organization that operates it endures.

Creditor Paper. — The instruments of group (b) are like those of the group just described in so far as they are based on a claim on income and assets. But even in this, as well as in other respects, they exhibit clearly recognizable differences. In the first place, they represent a money loan, and consequently each unit is a fractional part of a sum of money that is due and payable at a definite time. The claim on income is usually limited to a fixed per cent and ordinarily, does not fluctuate with the varying prosperity of the business. As the creditors of the business must be satisfied before there is a net profit to be distributed to the owners, this claim on income attached to creditors' investment paper takes precedence over that of ownership paper. The creditor group, moreover, ordinarily gives to the holder no right to a voice in the management of the business so long as the claim on income is satisfied. The claim on assets, that it carries with it, is in the nature of a deferred claim, contingent for effectiveness upon the actual failure to satisfy the current claim on income, or the inability of the issuing organization to pay in full the principal of the loan at the time of its maturity. These instruments, thus, are redeemable at a definite date and are not permanent rights of participation in the enterprise.

The horizontal classification is based on transferability, that is to say, on the right of the original holder to sell, or otherwise dispose of, the instrument to another. When considered from this angle investment papers fall into two groups, namely, (1) non-securities, which include shares and mortgages, and (2) securities, which include stocks, trust certificates, bonds and notes.

Non-securities. — Non-securities are investment papers characterized by their individuality. They occur, usually, as single instruments, and but infrequently in multiples of

like ones. As uniformity of denomination and value is the exception, each single unit is not freely interchangeable with every other unit of the same issue. Because of this lack of standardization and interchangeability of one unit with another, their transfer, or sale, from person to person, must ordinarily be accomplished through direct bargaining between buyer or seller, or their agents,—the selling price being agreed upon only after a careful analysis of the earning power or value of the economic capital back of each individual unit. For this reason, there exists no established permanent market where daily sales take place, and where the prices offered and asked may be ascertained from hour to hour, and day to day. Under these circumstances, trading in them cannot be conducted with such ease and facility as to characterize them as freely transferable. The chief use that is made of them is to render the capital invested in business enterprises conducted under personal ownership organizations, somewhat more mobile than would be the case without them.

Non-security investment paper is now not widely used as an instrument of organization largely because of the greater advantages offered by the more serviceable securities. Perhaps the best example of the use of non-security ownership paper is found in the limitedly transferable shares of the partnership associations of this country and England, and the *Teilhaberschaften* of Germany, both of which already have been explained.² The credit paper of this class consists of simple mortgages and other interest-bearing evidences of indebtedness that are especially secured by the assets of the business enterprise and the non-business property of the entrepreneurs. At its best, the non-security investment paper can exert but a moderate influence in shaping the forms of ownership organization.

Securities. — Securities, aside from incorporating in them—

² See partnership associations in Chapter IV.

selves the claim on income and assets, common to all investment papers, possess all of those qualities that have been mentioned as not possessed by non-securities, namely, existence in large numbers of like kind and like units, complete interchangeability of one unit for any other of a given issue, and unrestricted transferability. When they represent ownership interest they are stocks (shares of stock), or trust shares, and when a loan or an extension of credit, they are bonds or impersonal notes. It must be acknowledged, however, that in so far as the business organization is distinct from the entrepreneur who owns its securities, both stocks and bonds, when viewed strictly from the accounting standpoint, represent credit extended to the business organization; and also that the distinction between the ownership and credit factors, when measured by the extent of control exercised by the owner of the securities, tends to lose its definiteness and presents the aspect of a gradual transition from one to another. These characteristics, however, will be more fully explained in the following chapter on Corporate Securities.

Extent of the Use of Securities.—The issuance of securities for business and public use, has become very widespread. As the capital concept of the peoples of the world has become extended to give recognition and legal acceptance to these instruments of organization, governments, as well as business men, have not been slow in availing themselves of the advantages that they offer. Some idea of the extent to which the use of securities has spread throughout the world may be gained from the following table compiled by the "Moniteur des Intérêts Matériels" of Brussels³ which shows in millions of francs the securities issued by some thirty countries during the years 1909, 1910, and 1911.

³ Taken from R. Liefmann, *Beteiligungs- und Finanzierungs-gesellschaften*, p. 36.

Country	In millions of Francs		
	1909	1910	1911
Austria Hungary.....	446	955	927
Belgium.....	448	446	418
Belgian Kongo.....	.....	.....	298
Bulgaria.....	142	119	12
Canada.....	918	1257	1037
China.....	35	53	212
Denmark.....	77	162	42
Egypt.....	37	59	14
France.....	1727	1753	1332
Germany.....	3748	2996	2771
Greece.....	7	466	138
Italy.....	218	439	154
Japan.....	231	1632	140
Latin America.....	1455	3862	2724
Luxemburg.....	.....	.....	17
Morocco.....	150	98	.....
Netherlands.....	247	252	410
Norway.....	10	57	85
Persia.....	15	45	33
Portugal.....	164	2	87
Roumania.....	55	260	77
Russia.....	2060	1082	1466
Serbia.....	138	198	345
South African Union.....	.....	127	235
Spain.....	284	113	306
Sweden.....	61	139	50
Switzerland.....	436	258	240
Turkey.....	244	259	189
United Kingdom.....	2863	3721	1975
United States.....	8000	5661	4055

This table shows very clearly how the use of securities in business organization has spread even to the most backward countries, such as Persia and Turkey, and is a factor to be reckoned with the world over.

The extent to which the use of securities in business has progressed is admirably shown by the report of the Commissioner of Internal Revenue presenting statistics of income

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compiled from the income tax reports for the year 1917. The report classifies income from business according to the nature of the entrepreneurial organization into three classes, namely, that derived from individual business undertakings, from partnerships and from ownership securities or stocks. A tabular summary of the amount and per cent of income from these several sources, for some representative states and the United States as a whole follows.

SOURCES OF INCOME FROM BUSINESS FOR SOME REPRESENTATIVE STATES AND THE UNITED STATES AS SHOWN BY INCOME TAX RETURNS FOR 1917

(Amounts given in millions of dollars)

State	From individual business		From partnerships		From corporation dividends		Total from all these sources
	Amount	Percent	Amount	Percent	Amount	Percent	
California.....	155	57.6	37	13.8	77	28.6	269
Colorado.....	38	62.3	7	11.5	16	26.2	61
Georgia.....	40	64.5	9	14.5	13	21.0	62
Illinois.....	231	56.8	47	11.5	129	31.7	407
Iowa.....	160	84.6	13	6.9	16	8.5	189
Louisiana.....	32	59.3	10	18.5	12	22.2	54
Maryland.....	39	44.3	15	17.1	34	38.6	88
Massachusetts....	102	29.0	50	14.2	200	56.8	352
Minnesota.....	77	64.2	12	10.0	31	25.8	120
Pennsylvania.....	237	42.8	79	14.3	238	42.9	554
New Jersey.....	82	47.1	20	11.5	72	41.4	174
New York.....	339	37.7	205	19.1	527	49.2	1071
Washington.....	46	68.7	7	10.4	14	20.9	67
United States.....	2865	50.9	775	13.7	1992	35.4	5632

It is to be noted, that while the returns indicate that 35.4 per cent of all income from business for the United States as a whole came from dividends of corporations,

nevertheless, great variations in percentages are found among the several states, ranging from 8.5 per cent in Iowa to 56.8 per cent in Massachusetts. It is relatively low for agricultural states and high where manufacturing takes a prominent place among business undertakings. This leads naturally to the conclusion, that the corporation, as the chief securities-issuing type of ownership organization, is the favorite form under which to conduct a manufacturing or industrial enterprise. The reports of the Bureau of the Census seem to indicate that the personal ownership types of organization in manufacturing, while exhibiting a slight increase in actual number from 1904 to 1914, nevertheless show a relative decrease in comparison with securities-issuing types. In the number of wage earners employed and the value of their product, the decline of the personal ownership types is quite pronounced.

CHARACTER OF OWNERSHIP ORGANIZATION OF MANUFACTURING
ESTABLISHMENTS IN THE UNITED STATES ⁴

	1904		1909		1914	
		Per cent		Per cent		Per cent
Number of establishments:						
Individual.....	113,946	52.7	140,605	52.7	142,436	51.6
Corporation....	51,097	23.6	69,501	25.9	78,151	28.4
Other.....	51,137	23.7	58,385	21.7	55,204	20.0
Totals.....	216,180		268,491		275,791	
Number of wage earners:						
Individual.....	755,923	13.8	804,883	12.2	777,568	10.1
Corporation....	3,862,698	70.6	5,002,393	75.6	5,649,646	80.3
Other.....	849,762	15.5	807,770	12.2	679,123	9.7
Totals.....	5,468,383		6,615,046		7,036,337	
Value of product:						
Individual.....	\$1,702,830,624	11.5	\$2,092,061,504	9.9	\$1,925,518,298	7.9
Corporation....	10,904,069,307	73.7	16,341,116,634	79.0	20,177,084,844	83.2
Other.....	2,187,002,632	14.8	2,288,823,732	11.1	2,143,831,582	8.8
Totals.....	\$14,793,902,563		\$20,672,051,870		\$24,246,434,724	

⁴ From the reports of the Bureau of the Census.

Statistics for more recent years, indicate that the issuance of securities for business purposes, while it did suffer severely from the war, has, nevertheless, kept pace with preceding years. This is particularly true of the United States, of Japan, and of some of the South American countries which were not so seriously affected by the conflict as were the countries of Europe. But even in Europe, the quantity of securities issued for business purposes since the war is without precedent. This unusual rise may be ascribed in large measure to the decline in the value of money and the prospect of large profits inspired by high prices, caused by a general scarcity of goods. The issuance of the so-called "stock dividends" to avoid the technicalities of the federal income tax, is also a contributing factor in this country. The trend of security issues put out in the United States by railroads, industrial and public service enterprises is shown by the following table.⁵ The amount used for refunding is not an addition to the total of securities in the country, but represents the amount of new securities directly substituted for old ones.

⁵ From data compiled by Mr. Brown of the Guaranty Trust Co. of New York.

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NEW SECURITIES ISSUED IN THE UNITED STATES FOR BUSINESS PURPOSES, 1913-1920

	Railroad	Industrial	Public utility	Corporate Total
1920 (to May 30)				
Bonds.....	\$81,875,000	\$140,468,000	\$70,973,500	\$293,314,500
Notes.....	138,255,000	279,604,000	129,217,000	497,076,000
Stock.....		908,301,550	54,579,150	962,880,700
Total.....	\$220,128,000	\$1,278,373,550	\$254,769,650	\$1,753,172,200
1919				
Bonds.....	118,330,600	301,475,000	272,335,300	692,140,900
Notes.....	132,588,000	219,136,000	252,408,500	604,132,500
Stock.....		1,582,575,710	66,108,890	1,648,684,600
Total.....	\$250,918,600	\$2,103,186,710	\$590,852,690	\$2,944,958,000
1918				
Bonds.....	138,514,100	134,535,000	167,995,000	441,044,100
Notes.....	71,198,500	246,016,000	261,563,900	587,778,400
Stock.....		174,124,750	22,044,750	196,169,500
Total.....	\$209,712,600	\$554,675,750	\$451,603,650	\$1,215,992,000
1917				
Bonds.....	142,500,000	243,325,000	148,498,200	534,323,200
Notes.....	276,165,000	217,056,400	145,645,600	638,867,000
Stock.....	22,192,400	312,020,080	69,069,470	403,281,950
Total.....	\$440,857,400	\$722,401,480	\$363,213,270	\$1,576,472,150
1916				
Bonds.....	\$229,000,000	\$241,000,000	\$383,000,000	\$853,000,000
Notes.....	126,000,000	137,000,000	114,000,000	377,000,000
Stock.....	16,000,000	573,000,000	45,000,000	634,000,000
Total.....	\$371,000,000	\$951,000,000	\$542,000,000	\$1,864,000,000
1915				
Bonds.....	418,500,000	137,500,000	149,000,000	768,000,000
Notes.....	188,000,000	96,000,000	137,000,000	421,000,000
Stock.....	16,000,000	337,500,000	38,000,000	390,500,000
Total.....	\$684,500,000	\$571,000,000	\$324,000,000	\$1,579,500,000
1914				
Bonds.....	303,000,000	146,500,000	195,000,000	644,500,000
Notes.....	390,000,000	58,000,000	107,500,000	555,500,500
Stock.....	21,500,000	67,000,000	43,500,000	132,000,000
Total.....	\$714,500,000	\$271,500,000	\$346,000,000	\$1,332,000,000
1913				
Bonds.....	303,500,000	66,000,000	280,500,000	650,000,000
Notes.....	421,000,000	91,000,000	105,000,000	617,000,000
Stock.....	234,000,000	121,000,000	68,000,000	423,000,000
Total.....	\$958,500,000	\$278,000,000	\$453,500,000	\$1,690,000,000

The amounts used for refunding and new capital for some of the years covered in the above table are as follows:

	<i>Amount used for refunding</i>	<i>New capital</i>
1917	\$397,000,000	\$1,179,472,150
1916	325,000,000	1,359,000,000
1915	795,000,000	784,500,000
1914	550,000,000	782,000,000

The Transferability of Securities.—The quality of free and unrestricted transferability is one of the most important characteristics peculiar to securities. The instruments themselves, as well as all the rights, duties, powers and obligations that the owner of them possesses, may be freely transferred by sale, or any other legitimate means, from person to person in exactly the same way as a bushel of wheat might be sold.

This quality has given rise to brokers who specialize in serving buyers and sellers of securities by acting as agents for them. They facilitate transactions in securities by finding buyers for those offered and by finding securities for persons who wish to buy. To aid them in this work, these brokers have established stock exchanges,—institutions where brokers and others may gather to buy and sell securities for themselves and their principals. The largest of these exchanges are found in New York City, London, Paris and Berlin; but practically every country and many of the large cities of the world have their own smaller exchanges.

The freedom with which securities are bought and sold on these exchanges is well brought out in the following summary of annual sales of stocks and bonds on the New York Stock Exchange from 1912 to 1919.

SECURITIES SOLD ON THE NEW YORK STOCK EXCHANGE
1912-1919

Year	Shares of Stock (Number of shares)	Bonds (in dollars)
1912	131,128,415	\$675,213,500
1913	83,470,693	501,571,020
1914 ⁶	47,900,568	461,522,600
1915 ⁷	173,145,203	961,094,700
1916	233,311,993	1,140,851,950
1917	185,628,948	1,057,190,200
1918	144,118,469	2,067,827,500
1919	316,787,725	3,808,860,150

⁶ The Exchange was closed for several weeks in 1914 following the outbreak of the European War.

⁷ The great increase in the sale of bonds from 1915 on is due largely to government bond issues.

It should be borne in mind that the New York Stock Exchange is only one — although by far the largest — of about a score of exchanges operating in this country alone. Thus, these figures would have to be considerably augmented if they are to show the total dealings in securities in the United States. The average value of the shares of stock sold on the New York Stock Exchange in 1919, at a conservative estimate, can be taken at about \$75.00 per share, which would give the stocks sold on this exchange during that year a selling value of \$23,759,000,000, making a combined total for stocks and bonds of well over twenty-five billion dollars.

The importance that such statistics have in relation to the subject of business organization, arises from the fact that they show clearly the great liquidity that characterizes the ownership of economic capital when it has once been brought under the control and ownership of securities-issuing organizations.

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Further evidence of this liquidity is shown by the following table, which gives in parallel columns the total outstanding securities listed on the New York Stock Exchange by several of the larger American corporations, the par value of the securities sold on the Exchange during 1919 and the per cent that the securities sold is of the securities listed.

TABLE SHOWING SECURITIES LISTED ON THE NEW YORK STOCK EXCHANGE, THE PAR VALUE OF SECURITIES SOLD AND THE PER CENT OF TURNOVER OF A FEW LARGE AMERICAN CORPORATIONS FOR THE YEAR 1919

Name of Corporation	Securities listed on exchange	Par value of securities sold on exchange	Per cent of turnover
American Can Co.			
Stock, common.....	\$41,233,300	\$293,494,000	711.8
pref'd.....	41,233,300	4,134,500	10.3
Bonds.....	11,872,500	.....	....
Totals.....	94,339,100	297,628,500	315.4
American Locomotive Co.			
Stock, common.....	25,000,000	272,994,500	1092.0
pref'd.....	25,000,000	1,419,500	5.7
Totals.....	50,000,000	274,414,000	548.8
American Telephone & Telegraph Co.			
Stock.....	443,951,100	70,467,000	15.9
Bonds.....	407,434,080	16,226,500	4.0
Totals.....	851,385,180	86,693,500	10.2
International Harvester Company			
Stock, common.....	80,000,000	50,800,000	63.5
pref'd.....	60,000,000	1,587,300	2.6
Totals.....	140,000,000	52,387,300	37.4
International Mercantile Marine Co.			
Stock, common.....	39,230,900	607,560,000	1549.8
pref'd.....	48,867,300	448,375,500	917.5
Bonds.....	39,061,000	16,490,000	42.2
Totals.....	127,159,200	1,072,425,500	843.4

Name of Corporation	Securities listed on exchange	Par value of securities sold on exchange	Per cent of turnover
New York Central R. R. Company			
Stock	\$247,869,100	\$76,024,800	30.6
Bonds	688,285,200	14,779,000	2.2
Totals	936,154,300	90,803,800	9.7
United States Rubber Company			
Stock, common	67,679,500	433,855,500	641.0
pref'd.	62,036,400	5,370,000	8.7
Totals	127,715,900	439,225,500	343.9
Cluett, Peabody & Co.			
Stock	25,000,000	4,580,000	18.3
American Smelting & Refining Co.			
Stock, common	60,998,000	202,868,000	332.6
pref'd.	50,000,000	4,315,000	8.6
Bonds	31,881,400	3,169,000	9.9
Totals	142,879,400	210,352,000	147.2
United Cigar Stores Co.			
Stock, common	5,897,250	152,349,500	2600.0
pref'd.	4,527,000	151,000	3.3
Totals	10,424,250	152,500,500	1464.0
United States Steel Corporation			
Stock, common	508,302,500	3,257,047,000	640.8
pref'd.	360,281,100	18,309,500	5.8
Bonds	586,786,348	8,925,000	1.5
Totals	1,455,369,948	3,284,281,500	225.7

Some of these corporations exhibit extreme activity, and others a high degree of inactivity in dealings in their securities. Thus, while the sales of the securities of the American Telephone and Telegraph Company average only 10.2 per cent of those listed, the sales of the United Cigar Stores Company average 1464 per cent.

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It should also be noted, that the percentage of sales is lowest in the case of bonds and highest in common stock. This is no more than natural; the bonds are ordinarily safe and conservative investments whose price fluctuates little day by day, while the common stock frequently is highly speculative, with wide daily price fluctuations influenced in part, at least, by anticipated profits. This, however, is not the only reason for the enormous sale of stocks. An interesting insight into a contributing cause, is given by a report issued by the directors of the United States Steel Corporation on June 30, 1920. This report gives the approximate number of shares of the corporation's common stock held by investors and by speculators on certain dates as follows:

	June 30, 1920	Per Cent	December 31, 1916	Per Cent
Brokers	1,631,406	32.09	2,950,436	58.04
Investors	3,451,619	67.91	2,132,589	41.95
Total issue ...	<u>5,083,025</u>		<u>5,083,025</u>	

The stock held by the brokers is chiefly for the purposes of speculation, and not primarily for the return in dividends, which is the chief aim of the investor. Brokers' stocks are dealt in on the Stock Exchange like wheat or cotton on the Produce Exchange,—as though they were simply commodities whose price is determined by the general variation in intensity of demand and supply. It frequently happens that the stock of a corporation has practically no prospect of receiving a dividend, and yet has a speculative value that causes it to sell at \$10 to \$20 per share. Such was the case, for example, with common stock of the old United States Leather Company, which sold at about \$10 a share in the face of unpaid dividends aggregating 41% due the preferred stock, and payable before the common stockholder could hope to receive an income from his securities. The same condition has, from time to time, been very marked among stocks of defunct corporations. It is

because of their controlling power that they seldom lose their value completely so long as an attempt is made to continue the business.

The Principle of "Securitization" of Ownership.— Enough has been said of the nature, extent and effect of securities to show the importance of the rôle that they play in modern business organization. It is, indeed, very doubtful whether the great establishments found today in the fields of industry, commerce, transportation, finance, mining, etc., could operate at all under a system of private ownership of capital, but for the existence and general use of securities. Thus far, however, only the nature of securities themselves has been discussed, and nothing has been said about the principles that underlie *securitization* of business capital; that is to say, the use of securities as instruments of organization to give the holder thereof a claim to the designated business capital and to the income accruing to it.

Elimination of Personal Control, the Keystone.— Under the forms of organization that have thus far been described, the ownership, management and direction of the plant and equipment of the business remains in the hands of the natural entrepreneur, regardless of whether he is an individual proprietor or a partner. The power to withdraw is his, but when he exercises it he breaks up the organization. Such types of organization do not assure to the business a continuity of existence for a definite period of time, because they do not entertain the concept of the existence of the business separate and apart from the lives of the owners. Here, then, we find the first and most important point of departure from the principles underlying the personal ownership organizations. Through the use of securities the existence of the business becomes divorced from the life and being of the natural entrepreneur. It endures for a definite period

of time, or in perpetuity, unless voluntarily and lawfully abandoned by the operating and owning body. This body is interposed between the entrepreneur and the business in which he is interested. It is not a conscious, tangible being, but merely a hypothetical one; and thus, it is incapable of conscious action, except through the agency of natural persons. This delegation of authority is provided for, and the responsibility therefor allocated, through the medium of stock certificates. These, as already stated, incorporate in themselves a claim on income and assets and a right to participate in the management, etc., of the enterprise. It is the person of the holder of this stock, who exercises the rights that belong to it. The *securitization* of business, thus, results in the introduction of a new principle of entrepreneurial organization — the interposition of a securities-issuing body between the entrepreneur and his business capital. Technically speaking, the securities-issuing body itself is the entrepreneur of the business that it owns and operates. But, since it can function only through natural persons to whom also part of the liability may carry over, this technicality may be disregarded.

Types of Securities-Issuing Organizations. — Up to the present time three important types of securities-issuing organizations have been evolved. For all of them, the underlying principle, as explained above, is the same. The characteristics and qualities that distinguish one from the other are of a legal nature and of such importance to a thorough understanding of each of the types that they are reserved for fuller consideration and explanation in succeeding chapters.

The first of these types is a development of the partnership. A voluntary association, or company, is formed in whose managing board is vested the control of the business, while the ownership for all practical purposes is in the asso-

ciation itself. Membership in this association constitutes entrepreneurial participation in the business. This is obtainable through the acquisition of the shares of stock that are issued by the association, and that have all of the earmarks of securities. Creditor's interest is represented by bonds or notes. Such associations are known as *joint stock companies* or *joint stock associations*.

The second type is formed by interposing between the entrepreneur and his capital an artificial person, created by the state and existing only in contemplation of law. The right of ownership, and the power of operation of the business, is vested in this person who depends for conscious action upon policies dictated by the stockholders and carried out by directors and agents. This form is the *corporation*.

The third type rests upon the transfer of title to the property, together with power of management or direction, in trust to a person or body of persons. The entrepreneurs thus become the beneficiaries of the trust and share in the profits according to the number of units of trust certificates (securities) that they own. This form is called the *securities-issuing trust* or *trust on shares*.

It is under these three types of entrepreneurial organization, that the great business undertakings of today are conducted. Of the three, the corporation offers the greatest inducements to the undertaker of a business. The joint stock company has seen its best days, and the use of the securities-issuing trust has as yet not come into general favor. Thus, the corporation is, today, the ownership foundation upon which have been erected the world's big business establishments conducted as private enterprises.

CHAPTER VI

THE JOINT STOCK COMPANY

THE principle underlying all securities-issuing organizations is the creation of a business organization that shall enjoy an existence separate and apart from the members that compose it. To accomplish this there must be formed an organization that has more or less permanent control over a definite amount of business capital contributed to it by its members, and that will at the same time permit a member freely to withdraw without disrupting its unity. The earliest approach to the realization of this idea was the joint stock company.¹

Definition. — From the legal standpoint, the joint stock company is a partnership, created by a contract in the form of written articles of association that set forth clearly the conditions under which the company is to be formed and operated. It may be defined as a voluntary association of individuals for profit, having a capital divided into transferable shares, the ownership of which is a condition of membership, directed by a board selected by the members and operated by its agents. In other words it is a securities-issuing partnership that, in a limited respect, has an existence apart from the lives of its members. Thus, it is essentially a common law organization.

Formation. — In the United States a joint stock company may generally be formed under common law rules by

¹ In France the nearest approach to our joint stock company is the *société anonyme par actions*, in Germany the *Aktiengesellschaft* and in Italy the *società per azioni*.

drawing up articles of association which are subscribed to by the organizers. However, in most of the states these laws have been reduced to statutes. In a few, special requirements regulating capitalization, securities, registration, method of bringing suit, etc., exist. In New York, for example, these companies must be formed under the same general laws that govern the formation of a corporation. That is to say, the organizers must frame their articles of association, submit them to the secretary of state, pay a franchise tax and have the company properly registered with a designated official in the county and the state. In addition to this, every stock company formed under the laws of this state must, within sixty days after its formation, and thereafter in each January, file with the secretary of state and with the county recorder a written certificate giving its name, date of organization, number of stockholders, names and residences of its officers, and its place of business. In England and the countries of Continental Europe the formation of these companies has been regulated more or less strictly ever since the great stock swindles of the early eighteenth century which were brought to a climax by the company formed by John Law to finance France. Thus, the common law rules for the formation of joint stock companies have been almost universally superseded by statutory regulations. In some countries, as in Germany and Belgium, these are very strict and exacting, while in England and the United States the tendency is to adhere more closely to the common law practice.

The *Articles of Association*—the name applied to the written contract by virtue of which the company is created—usually contain statements setting forth (1) the name under which the company is to do business, (2) its place of business or main office, (3) the objects for which it is organized, (4) its capital, number of shares and their manner of assignment or transfer, (5) the number, manner of

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selection and duties of the officers, directors and trustees, (6) the duties, rights, obligations, etc., of the members, (7) procedure for amending or altering the articles of association, (8) the term of life and the manner in which voluntary dissolution may be effected.² Where the common law rules of formation generally prevail, the organizers enjoy considerable latitude in framing the articles and may provide any number and variety of special features.

Capitalization and Stock.—The capital of the joint stock company is customarily stated as a definite sum of money, which has been or is to be contributed by the organizers and others, who receive shares of stock to represent their contributions. But there are exceptions to this general rule. In organizing joint stock companies to operate the beet sugar enterprises of Germany the farmers were frequently given shares of stock in return for which they signed contracts obliging themselves to furnish the company annually a stipulated quantity of beets with a stated sugar content. If they failed to keep their contract the shares would revert to the company. The capital, or joint stock as it was formerly called, remains as the indivisible property of the company, so that a shareholder may not withdraw from the company that part to which he is entitled except in case of dissolution. If he desires to withdraw from the enterprise or to liquidate his interest in it he merely assigns or sells his shares to some other person, without ordinarily affecting the capital over which the company has control.

Ownership is represented by shares of stock which have all the earmarks of securities. Each share is usually a like fractional part of the capital. Thus, in the articles referred to in the preceding note it is provided that the capital of \$3,000,000 is divided into 30,000 shares of \$100 each

² See the copy of the Articles of Association of the Pierce-Fordyce Oil Association—Part VI, Form 4.

all of which has been paid in by the subscribers. In both England and America it is not necessary that the company shall have received the full amount of the stated value of each share in payment thereof, but in Germany and Belgium the statutes prescribe that no stock may be issued by the company for cash, property or services of less value than the par of the stock. Certificates representing single shares or multiples thereof, are given the shareholders as evidences of ownership. Each certificate states that the holder, who is usually named, is the owner of the stated number of shares of the capital stock of the company, sets forth the more important limitations on the rights and privileges of the holder, the procedure to be followed in case of transfer or assignment and bears the signatures of the president and secretary of the company. The transfer is effected when the holder of the certificate signs it over to another person who has the transfer recorded on the books of the company.

Ordinarily, each shareholder has a claim on the unencumbered assets and earnings of the company equal to the same percentage that his shares bear to the total number of shares that are outstanding, and also one vote for each share that he owns. However, several classes of shares may be provided for, so that the holders of one class may be given preference over the holders of other classes in respect to one or more of the above points.

Other securities such as bonds and notes may also be issued as part of the series of securities. But, in practice, securities of this type seem to have found little favor, probably because they impose a relatively heavy risk upon the shareholders who, in most cases, assume partnership liability.

Internal Organization.—The elements of internal organization of the joint stock company are (1) the body of shareholders, (2) the board of governors or directors, (3)

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the trustees and (4) the officers and agents. It is through these that the company becomes an active business unit.

(1) The body of shareholders is a functioning element of the organization only when it has been properly called together at an annual or special meeting in accordance with the provisions of the articles of association or the statutes. At the regular or annual meetings, the shareholders vote to elect persons to serve as directors for the ensuing year, and to pass upon any and all matters that the board may see fit to place before them. The body of shareholders also has power to amend and alter the articles of association, to dissolve the company or abandon the enterprise. This body, thus, constitutes the basic or fundamental element in the administrative organization. Generally it is too large and unwieldy to participate in any direct administrative work, and for this reason it is usually stipulated in the articles that the active control of the business shall be vested in the board of directors or governors. The individual shareholder himself has absolutely no power to bind the company in any business or other transaction. Here, then, is one important point of difference distinguishing the joint stock company from the partnership.

(2) The board of directors, governors or managers is usually authorized to exercise "full power and authority in the conduct of the business," to call meetings of the board and of the body of shareholders, to appoint trustees and officers and to declare dividends.³ Such boards are nearly always elected by the holders of the stock certificates. Ownership of at least one share of stock is ordinarily prescribed as a qualification for membership on the board: and the term of office is one year.

³ The commercial code of Germany provides that dividends shall be declared by the body of stockholders properly assembled in a meeting called for that purpose.

(3) Three or more trustees to be appointed by the board of directors are provided for in the articles, "in whose name all investments and title to all property are to be made and held under a declaration of trust for and on behalf of the association." The trustees are necessary if the company is to hold any real estate, since under the common law real property can be held only in the name of a person. In some European countries trustees are dispensed with by statutory provisions empowering the company to hold such property in its own name.

(4) The officers are usually a president, a vice-president, a secretary and a treasurer. These are appointed by the board of directors, which may also delegate to them such of its powers and duties as may be consistent with the articles of association. In addition to this, the articles specifically assign to each of the officers such duties as it is customary for them to perform.

External Relations—The joint stock company is not a legal entity. In this respect it is like the partnership, for it cannot sue or be sued, in its own name. If a legal action is to be brought by or against the company, it must be by or against one or more of the members, severally and jointly. Some of the states have modified this rule somewhat by statute. In New York, for example, suit must first be brought against the president or treasurer, and if no satisfaction is secured in case of a judgment against them, the complainant may proceed to sue under the common law rule. However, modifications such as the above have no power or effect in states other than the one in which they have been made. Thus, in a case decided in 1871 it was held that a citizen of Massachusetts might sue a member of a New York joint stock company to recover a claim against the company without first bringing his action against the president or the treasurer.⁴

⁴ *Taft v. Ward*, 106 Mass. 518.

Furthermore, the members are individually liable for the entire debts of the company, just as in the partnership. However, in practice, limited liability may be secured by providing in any and all contracts made by or in behalf of the company, that it is specifically understood, as a part of such contract, that the company's property solely is bound. But such a provision must be made part of the terms of the contract to be binding.

Permanence and Stability.—In the matter of dissolution the partnership principle is not followed. Although at law, the articles of association when acted upon do not set up a legal entity, they, nevertheless, do establish a business entity, or unit, which the law recognizes as somewhat distinct from the persons of the several members. Consequently any member may freely withdraw, may become a bankrupt or may be taken by death without affecting the continuity of the organization. The company may be created in perpetuity or for a definite number of years. In the latter case, its period of life may be extended by renewal of the agreement. The difficulty of liquidating the assets and distributing the receipts among the several shareholders, is of itself a powerful influence working toward the renewal of the agreement.

With the exception of forced dissolution arising out of a condition of insolvency, or a decree of the courts requiring the discontinuance of the business because of gross and continual violation of the law, all other causes of dissolution may be considered to be voluntary. The joint stock company is, therefore, one of the most stable and at the same time one of the most flexible types of ownership organization in use today. This characteristic has been chiefly responsible for the remarkably long life enjoyed by some of these companies. The British East India Company, for example, was formed about 1600 and continued its operation until the middle of the nineteenth cen-

ture. In this country the Adams Express Company and others began business as joint stock companies a few years prior to 1860 and, in 1919, were still operating under this form of organization.

Value and Use of the Joint Stock Company.—The heyday of the joint stock company was the great period of colonial expansion beginning during the latter part of the sixteenth century and closing with the end of the eighteenth century. We are told that the great trading companies of that period were nearly all organized as joint stock companies through grant of a charter by the crown giving them trading monopolies in certain sections of the world. It was not until after the industrial revolution and the growth of large scale industrial enterprises, that they were organized for industrial, as distinct from commercial, purposes. They exist to-day in large numbers in England and the countries of continental Europe, but are extremely rare in the United States. One reason for this is that in this country, corporations could be easily and inexpensively formed and were given limited liability as early as 1819, while in England the cost of incorporation was heavy and limited liability was not generally given to corporations until 1862; and a similar condition prevailed on the continent. Even to-day in many countries of Europe it still is more difficult and costly to form a corporation than a joint stock company; but even so, the former is gradually displacing the latter. Thus, according to the German Official Commercial Register, we find that there were, in use in 1909, 16,508 corporations as against 5,222 joint stock companies.

On the whole, it may be said that although the joint stock company has quite generally given way to the corporation as the favorite type of securities-issuing organization, it nevertheless still has marked advantages over the partnership. If properly organized the danger from part-

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nership liability is too remote to act as a serious drawback; and the freely transferable interest represented by shares of stock as well as the stability of the organization are advantages that cannot be overlooked. It can be successfully used where the persons originally interested in the project subscribe to all of the stock and hold it until the business is on a sound, paying basis. However, the unlimited liability accepted by the shareholder has worked as a deterrent, preventing the company from finding a ready market for its securities, particularly if the business is only in the course of establishment, and has not yet been fully built up and put into operation. Another disadvantage applicable to companies of this type organized in the United States, is the fact that any special statutory privileges granted them in any given state have no force or effect in other states. These disadvantages—moderate though they are—leave little doubt concerning the ultimate fate of the joint stock company. It has already been put in a position of minor importance and the probability is strong that it will continue to lose favor, and, in time, will practically be driven out of use by the corporation.

CHAPTER VII

THE CORPORATION—ITS NATURE AND ESSENTIAL CHARACTERISTICS

THE corporation is the second, and by far the most important one of the securities-issuing, entrepreneurial organizations that are before us for consideration. Because of its great importance in modern business, it will be necessary to devote several chapters of this text to an explanation of its intricate features and characteristics. It is perhaps better to outline its broad, general features first, and then to take up in greater detail its mechanism and methods of operation.

The corporation did not spring spontaneously into general use as a form of entrepreneurial organization. Only through the slow process of a change in social custom did it win for itself the place that it now holds in the business world. As a legal institution it was known to the Romans, who, however, made little use of it for business purposes. During the middle ages, in England as well as on the European continent, it came into general use as a political institution. The boroughs and towns of that period were granted corporate charters by the crown or suzerain lord and were operated as municipal corporations. Its use in business developed gradually, beginning about the sixteenth century. By the close of the eighteenth century it had fairly well established itself in that field as a common law institution. But even at that time it enjoyed a bad repute, as is evidenced by the fact that some of the early books on political economy condemn it in no uncer-

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tain language.¹ Even as late as 1840, the governor of the State of Massachusetts in a message to the legislature requested the passage of stringent laws against the use of corporations, because they were so generally organized for fraudulent purposes. To-day, however, it stands unchallenged as the leading form of entrepreneurial organization in the business world.

Definition.—Blackstone, in his *Commentaries on English Law*, published in 1765, defines the corporation in the following words: "A corporation is an artificial person created for preserving in perpetual succession certain rights, which being conferred on natural persons only, would fail in the process of time." Another definition,—and one that has become the most famous in the annals of American jurisprudence,—is that given by Chief Justice John Marshall of the United States Supreme Court in his decision in the Dartmouth College case in 1819. There he defines the corporation as "an artificial being, invisible, intangible, and existing only in contemplation of law." The first of these definitions lays emphasis upon the continuous life of the corporation, which endures under common-law rules in perpetuity, and therein differs materially from natural persons whose rights expire with them on death. The second definition describes, in admirable terms, this artificial person that has a legal being and legal rights, powers and privileges of its own, apart and distinct from those of the natural persons, who, as entrepreneurs, avail themselves of it for the purpose of owning and conducting a business enterprise. It is invisible and cannot be seen. It is intangible and cannot be touched. And yet it is a real legal person that can in its own right own and operate a business whose capital may consist of real economic goods, as plant and equipment, of money capital or of

¹ See Harvard Studies, *History of English Monopolies, Seventeenth Century*.

securities. But even in view of all this, it is, nevertheless, an impersonal type of organization; for it cannot function, but through the agency of natural persons.

Legal Entity.—The fact that the corporation is an artificial person, fixes its status as a legal entity, a being with all of the rights, privileges and obligations of a person before the law. Herein, it differs fundamentally from the partnership and joint stock company. The latter can sue and be sued only in the names of their several members, but the corporation may sue and be sued through its officers or agents, in the same way as any natural person. It may own real estate and any other property in its own name. In fact, it may be granted the right to enjoy and to exercise, within reasonable limits, all rights and powers and privileges that a natural person might avail himself of when engaged in a similar business undertaking.

Creation.—As an artificial person, the corporation is a creature of the state. It is created through the exercise of sovereign power by the state, within lawful constitutional limitations. Certain natural persons, desiring to form a corporation, petition the sovereign state, through the state's secretary, or some other designated official, for a charter—a document that is evidence of the creation and existence of the corporation, and, at the same time, circumscribes and defines its powers, rights and privileges. The grant of such a charter to the petitioners, who are called incorporators, constitutes—when acted upon by them—a legal contract between the state on the one hand, and the incorporators as agents of the corporation on the other. Once having granted such a charter the state, in this country, is estopped by a provision in the Federal Constitution from revoking or in any way impairing the obligation of such a contract. Thus, it cannot subsequently alter the provisions of the charter, unless by specific reservation or general statute it reserves that right as a condition of the

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grant. As a case in point, we need but to refer to the Dartmouth College case mentioned above. This institution was granted a charter in perpetuity by the British King while New Hampshire was still a British colony. The war of independence intervened between the time of that grant and the attempt by the State of New Hampshire to revoke the charter and to reorganize the college to suit itself. The United States Supreme Court held that the charter constituted a contract between the College and the sovereign power of the crown, and that the state of New Hampshire simply stepped into the crown's place and was bound under the Constitution of the United States, to respect the contract; and that consequently, it might in no way alter the provisions of that contract without the consent of the other party. This applies with equal force to business corporations. There is now no state in the Union which will grant a corporation charter without some form of reservation. The same principle is quite generally followed by all political jurisdictions empowered to grant charters, especially for business purposes, whether they be independent nations or not.

In the early history of corporations, the charters were granted by special act of the creating power. In this country, a special act of the legislature of a state was necessary to create a corporation; while in England and the European countries this power was vested in the crown or head of the government. This procedure gave rise to charter buying, bribery, favoritism and many other objectionable practices. It also resulted in a complete lack of uniformity, not only as to the powers granted, but also in the matter of control, restrictions and obligations. The effect of these conditions was to retard the general use of this very serviceable type of entrepreneurial organization, rather than to stimulate it, and to give rise to a strong and insistent demand for greater equality of opportunity and reform in procedure.

By the middle of the last century, however, most of the creating jurisdictions had adopted general statutes laying down uniform rules in the form of general incorporation laws for the formation and control of corporations. The fundamental principles underlying these laws were considered to be of sufficient importance to be incorporated into the constitutions of many of the states of our Union. Nevertheless, as between states, there is, even today, an astounding lack of uniformity in the laws governing the formation, operation and control of the corporate form of organization. In this particular, the United States is still far behind most foreign countries, which have laws that apply uniformly throughout their territory. The desirability of a uniform federal corporation law for this country has, by no means, gone unrecognized; but such bills, as have sought to provide for this, have quite generally failed of passage in Congress because of doubtful constitutionality.

Sphere of Activity.— The corporation, like the federal government, possesses only delegated powers. It may do only those things, and enjoys only such powers and rights as have been specifically delegated to it in the charter. A corporation that has been granted a charter empowering it to go into the coal-mining business, may not subsequently extend its field of operations to the manufacture of steel or to railroading. It must confine its business to that specifically designated and defined in its charter. Furthermore, a charter granted by one state to a corporation gives it no rights in any other state. The clause in the Federal Constitution prohibiting any state from passing a law denying to the citizens of any state the same rights and privileges as enjoyed by the citizens of the several states, is held by the Supreme Court, in the case of *Paul v. Virginia*, not to apply to corporations, because corporations, although they are persons, are not citizens. Any state may, there-

fore, place cumbersome restrictions on foreign corporations; that is to say, on those chartered by other states. The same rule applies also to alien corporations holding charters granted under the laws of foreign nations. Of course, the principle of mutual reciprocity is quite generally followed in the treatment accorded by any legal jurisdiction to the corporations of others. Indeed, without the general application of this principle in the United States, great difficulties would attend the use of the corporation for business purposes whenever its activities stretched out beyond the borders of the state that granted the charter. However, the limited sphere of activity inherent in the corporate form of organization is more theoretical than real and, as we shall see later, it does not, in practice, become a serious obstacle to its general use.

Ownership and Liability.—Those persons, whether natural or artificial, whose names appear on the books of the corporation as owners of shares of its stocks are the entrepreneurs of the business. As entrepreneurs they have a claim on the unencumbered assets of the corporation, but no title to its property. This is held by the artificial person of the corporation itself. As a result of such an arrangement there is a double aspect to the question of assumption of risk or liability. The corporation itself assumes unlimited liability, for all of its property may be taken to satisfy the claims of its creditors. Among these creditors we may rightfully place the stockholders, who on dissolution, are entitled to that balance of the assets remaining after all debts have been paid, each stockholder sharing according to the extent of his holdings. But the stockholders, themselves, as entrepreneurs, also assume liability. Under common law this was unlimited, but in practice it was frequently unenforceable upon each individual stockholder because of practical difficulties. The principle of limited liability which now applies to stock-

holders is of statutory origin. It made its appearance in England during the decade 1850–1860, but is found much earlier in the United States. In New York it is encountered as early as 1811, in Connecticut in 1817, and in Massachusetts in 1829. Under it the stockholder is liable only up to the face or par value of the stock that he holds. But in many states it is now possible, through the use of treasury stock, to restrict it still further, namely, to what the stockholder has actually contributed to the corporation, even though this may be but a fraction of the par value of his stock. It is this principle of limited liability, more than any other, that is responsible for the bad repute that has attached itself to the corporation in America. Of recent years some states, notably California and Minnesota, have attacked this problem by providing for *double liability* under which the stockholder must pay the full par value of the stock to the corporation, and in case of bankruptcy, if the liabilities exceed the assets, he may be called upon to contribute an additional amount up to the limit of the par value of the stock that he holds. Double liability applies quite generally to stockholders of banking corporations throughout the United States; but for business corporations it is restricted to the two mentioned states.

Direction and Control. — The direction and control of the corporation is vested in the stockholders and the directors, while the actual conduct of its daily business affairs is a duty imposed upon its officers and employees.

The stockholders direct the policies of the corporation only when acting as a properly organized body, through the exercise of the voting power vested in them by virtue of the stock that they own. For this purpose, each share ordinarily is assigned one vote on each proposition placed before the stockholders. It requires a majority of votes to carry a proposition. The stockholders, while they do determine the broad general policy of the corporation,

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have, as stockholders, no share in directing the ordinary affairs of the corporation, but elect for this purpose, at an annual meeting, from among their number a board of directors, for which they may prescribe rules of conduct in the form of by-laws.

The board of directors is entrusted with the conduct of the business, including the distribution of the income. They are responsible to the stockholders and the creditors for any losses resulting from misconduct or violation of law or charter powers of the corporation.

Officers, such as a president, vice-president, secretary and treasurer, are chosen by the board of directors. They are the agents through which the corporation conducts its daily business. To assist them in their work, they employ such other persons as they deem necessary.

The whole scheme or organization for purposes of direction, as found in the corporation, resembles very closely the representative type of government common to the United States. The stockholders may be viewed as the body of citizens, the directors as the legislature, and the officers as the administrative officers of the state. The chief difference between them lies in the method of choosing the officers. The officers of the state are elected directly by the people, while those of the corporation are chosen by the directors.²

Permanence and Stability.—One of the most characteristic features of the corporation is its remarkable stability, the result of its continuity of existence. The term of life of the corporation is determined by the charter granting powers, and is in no way dependent upon the life of natural persons. The early corporations were, with few exceptions, chartered in perpetuity. Under such grants,—barring voluntary dissolution, bankruptcy, and dissolution

² While this plan quite generally prevails in the United States, it is not universal.

by court order for violation of law,—they may endure as long as the social order continues, even though they may never function as established businesses. Corporations may, even now, be chartered in perpetuity under the laws of the state of Delaware and a few others; but with these exceptions, this practice has been quite generally discontinued, not only in this country but also abroad. Under the present corporation laws of most of the American states and foreign countries, the term of the charter is from twenty to fifty years; but, as a rule, such liberal provisions for renewal are made, that the set period of life may be looked upon as a provision designed to retain a firmer control over the corporation, than an absolute termination of its existence.

Exclusive of expiration of the charter, the corporation may be dissolved and terminated through (1) voluntary action of the stockholders, (2) bankruptcy or insolvency, (3) by court decree in cases of violation of law and (4) by the state for default in complying with provisions of the grant.

As a rule, in case of bankruptcy or insolvency, the assets of the larger corporations are not sold at auction as is customary in the case of personally owned enterprises, but the whole business is turned over to the creditors, who agree upon such financial readjustments as may be deemed necessary to put the business back on its feet. Such readjustments come technically under the subject of corporation finance and are called reorganizations.

Onerous Obligations.—The obligations placed by law upon the corporation, while they may not be onerous, are, nevertheless, at times quite burdensome. These may be properly classified under three heads (a) reports, (b) taxes and fees, and (c) regulations governing the operation of the corporation. In Germany, England and a few other foreign countries, they may be considered as burdensome

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because of the comprehensiveness, the minute detail and exactness demanded in the required reports to the government and to the stockholders, because of the publicity required, in matters of promotion, finance and operation, as well as because of the taxes and close adherence to strict rules of procedure. In the United States they are burdensome more because of their number rather than for the reason above given. An enumeration of the more important of these requirements to be found in the United States will suffice at this place to indicate their character.

(a) Reports:

1. Local tax reports—made to local subdivisions of the state.
2. State tax reports—made to each state in which the corporation does business.
3. Federal tax reports—made to the Commissioner of Internal Revenue, United States Treasury Department.
4. Annual reports—made to the secretary of state in each state in which the corporation does business as required by that state. They are for public record.
5. Sundry reports—made by corporations engaged chiefly in public service enterprises to state service commissions and to the Interstate Commerce Commission.
6. Special reports—made to the Federal Trade Commission as required by it.

(b) Taxes:

1. Organization taxes payable to the chartering state.
2. Annual franchise taxes payable to each state in which the corporation does business.
3. General property tax payable to the subdivisions of the state in which the property is located.
4. Inheritance taxes payable to a few states and to the federal government.

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5. Income taxes payable to some states and to the federal government.
6. Other taxes and fees such as a stock transfer tax, recording fees, transcribing fees, etc., payable to the state and in some cases also to the federal government.

(c) Regulations governing operation:

These include such requirements as notices of annual and special meetings of stockholders, notices of directors' meetings, and the declaration of dividends, etc.; as to the kinds of books and accounts that shall be kept, and as to annual reports to stockholders, etc.

Classification of Corporations.—Not all corporations exhibit the same features in their organization. There is no general stereotyped form that serves equally well for all purposes. The corporation has been put to such a great diversity of uses that it became advisable to classify them for legal and legislative purposes.

The first basis of classification rests upon the object for which the corporation is to be formed. Three such objects have become generally recognized. First, the corporation is found to be very useful in organizing for governmental purposes, as cities, counties, towns, school districts, and other political subdivisions of the state. These are known as *municipal corporations*. Not being organized for profit, they issue no stock, but may, and usually do issue bonds.

The second class is distinguished by its social, rather than political object. It includes churches, schools and libraries, clubs, lodges and fraternities, and charitable organizations. Here also, the object is not private financial gain or profit, but an intangible social benefit. This benefit cannot be measured, and consequently the corporation has no use for stock, which serves merely as a convenient medium whereby to distribute the benefits that accrue

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to the participants. This type is called *eleemosynary corporations*.

The third class includes all corporations organized for profit. These are commonly referred to as *business corporations*. They all issue stock, and usually also bonds. For purposes of greater effectiveness of control through statutes, they are grouped according to the field of their operations as industrial, commercial, public service and financial corporations; and in each of these groups are several types.

CLASSIFICATION OF CORPORATIONS

A. *Non-stock corporations*

- | | | |
|-----------------|---|---|
| 1. Municipal | { | cities
counties
school districts
towns, etc. |
| 2. Eleemosynary | { | churches
hospitals
schools and libraries
clubs, lodges and fraternities
charitable institutions |

B. *Stock Corporations*

- | | | | | |
|-------------|---|----------------|---|--|
| 3. Business | { | Industrial | { | Manufacturing
Mining |
| | | Commercial | { | Wholesaling
Retailing |
| | | Public Service | { | Railroads
Street railways
Gas, heat and light companies
Telephone and telegraph companies |
| | | Financial | { | Banks
Trust companies
Insurance companies |

Advantages and Disadvantages.—From the foregoing brief description of the corporate form of organization,

its advantages and disadvantages, as they present themselves to the entrepreneur, have become apparent.

Its advantages may be summarized as follows:

(1) *Flexibility*. It lends itself as readily to small as to large undertakings because the numbers of entrepreneurs or owners that may participate in it can be large or small; its business operations can readily be contracted or extended through the simple expedient of charter amendment, and it has within easy reach the vast reservoir of the investable capital of nations, which enables it to collect large amounts of capital in the form of small contributions from a great number of investors.

(2) *Stability and permanence*. Unlike the personal ownership types of entrepreneurial organization, its being is not dependent upon the lives of the entrepreneurs nor yet subject to their capricious whims, but it enjoys a definite term of life which, at its expiration, is easily extended.

(3) *Transferability of ownership interest*. The quality of transferability inherent in the securities that it issues, makes it possible for the entrepreneur easily to withdraw from the enterprise without in the least disturbing the organization. There is usually a ready market for the stock in large or small quantities.

(4) *Limited Liability*. The entrepreneur can definitely predetermine and limit the risk of loss that he assumes. This he cannot do under the personal ownership types, or even under the joint stock company.

(5) *Centralized control*. The personal ownership types of organization do not permit of the association of a large number of entrepreneurs in a single enterprise, nor do they offer the same facility in attaching specialists to the business through the entrepreneurial bond. The corporation, however, does offer these opportunities, and in addition it furnishes the mechanism whereby the control of the greatest and most ramified undertakings may be centralized in the hands of a relatively small group.

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The disadvantages also have been touched upon. They are here briefly summarized.

(1) *Government regulation.* The corporation as a creature of the state is subject to constant regulation. This in itself would not be a serious disadvantage were it not for the fact that at practically every session of the state legislature existing laws and regulations are changed, or entirely new ones adopted. The policy of states in this respect shifts from laxity to aggressive regulation and restriction according to prevailing public sentiment. Hence, it is impossible to forecast from one year to the next what these regulations will be.

(2) *Greater burden of fees and taxes.* The corporation must pay to the states in which it operates and to the federal government many kinds of taxes and fees from which the personal ownership types of organization are exempt. Not least among these is the initial expense of the organization tax and the annual franchise tax which it must pay to continue its existence.

(3) *Restricted sphere of activity.* The corporation may do only those things that it is specifically authorized to do, while the entrepreneurs in the personal ownership organizations may do anything that is not specifically prohibited. The former operates by permission and the latter by right.

(4) *Limited credit.* In theory the limited liability enjoyed by the stockholder of a corporation should work to restrict the credit that may be extended to the corporation to an amount determined very largely by the selling value of the assets or the capitalized net earnings. Other things being equal, the same business, where operating under a corporate form, should not enjoy the same high credit standing that it would have as a partnership. But in practice, this theory does not always hold; and frequently, in spite of the limited liability, the corporation has a better credit standing than a partnership would have.

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This is more particularly true of corporations operating large undertakings whose bond issues often exceed the selling value of the properties under their control. For example the old United States Shipbuilding Company issued \$24,500,000 in bonds against assets valued at less than \$16,000,000.³

³ Dewing, *Corporate Promotions and Reorganizations*.

CHAPTER VIII

CORPORATE SECURITIES AND CAPITALIZATION

THE CORPORATE SECURITIES

General. — The corporate securities, like all types of securities, are of two general classes, namely, those that represent an ownership interest in the business, and those that represent a creditor's interest. The former are called stocks and the latter notes and bonds. Of each class, there are numerous kinds exhibiting all shades of characteristics that permit of gradual gradation from stocks to bonds; but there is, nevertheless, a fairly well recognized line of cleavage between them.

Capital Stock. — The number of shares of stock that the charter authorizes the corporation to issue is its capital stock. It is usually expressed in terms of money, in which case the charter will further state the number of shares into which it is divided. Thus we find in the charter of the Midvale Realty Corporation the following clauses:

“Third. — The amount of capital stock of said corporation shall be One Million Dollars (\$1,000,000).

Fourth. — The number of shares of which said capital stock is to consist shall be Ten Thousand (10,000) shares of the par value of One Hundred Dollars (\$100) each.”

Such shares are said to have a *par value*, that is, a nominal value assigned to each share. A common practice is to assign a par value of \$100 to each share, but this is a matter of choice within the limits fixed by provisions of law. The shares of stock of the Pennsylvania Railroad

have a par value of \$50, while those of the Carnegie Steel Company were \$1,000 each. Under the laws of the state of New York the par value must be \$5, or multiples of that figure, which permits of considerable variation in this matter. Other states permit of the issue of stock of a nominal par value; for example, the Wind River Refining Company, a Maine corporation, has a share with a par value of only one mill.

In many of the states it is now permissible under statute law, to state in the charter merely the number of shares of which the capital stock is to consist, without assigning to each share any par or nominal value whatever. These shares are known as shares without par value, or *non-par value shares*. A good example of such a law is that of New York. This type of share is rapidly gaining favor, for, as one writer¹ puts it, "It is argued that such shares lacking the 'price ticket' of a nominal value, will force the investing public to investigate the real value of the enterprise and the real probability of profits, and thus determine the real value of the shares much more surely and quickly than under the present system of valued shares." In most states, the incorporators are not restricted to the exclusive use of either the one type or the other, but may use both.

Issued and Unissued Stock.—The stock of the corporation does not, merely by virtue of a charter provision authorizing it, exercise an effective claim on the income of the corporate business. To do so it must be sold by the corporation, or be given in exchange for services or property. By this means does the corporation make connection with entrepreneurs who are called stockholders. The stock that is so given out by the corporation is called *issued stock*, while the bal-

¹ Thomas Conyngton, *Corporate Organization and Management*, p. 70.

ance of the authorized capital stock is *unissued*. The United States Steel Corporation began life with an authorized capital stock of \$1,100,000,000; and at the end of the first year had issued \$1,018,583,600, the difference being unissued. The unissued stock forms a reserve which may be sold on the market to secure additional funds or may be otherwise disposed of as the stockholders may see fit, so long as they remain within the law.

The Stock Certificate.—The instrument that is placed in the hands of the stockholder as an evidence of his ownership of issued shares of stock is the stock certificate. It usually sets forth the name of the corporation, the state of incorporation, the authorized capital stock, the par value of the shares, the name of the holder, the number of shares represented by the certificate, requirements as to transfer of ownership, the date of issue, the number of the certificate and the signatures of such officers of the corporation as may be required by the charter or by-laws. If the stock possesses any special feature, these are usually also printed on the face of the certificate. On the back of each certificate is a form to be filled in to effect a transfer of ownership.²

Full-Paid and Part-Paid Stock.—If the corporation, in exchange or payment for its stock, has received money, property or services whose fair market value, in the best judgment of the directors, equals the face value of the stock, then the stock is said to be *full paid*. The corporation ordinarily also gives up any privilege it might have of levying assessments upon the stockholder in case it gets into difficulties. Most stock is issued as full paid and non-assessable, by virtue of which the stockholder's liability toward the corporation will have been satisfied in full. It frequently happens, however, that stock is issued as full paid and non-assessable, when in fact the corporation may

² See Forms 21-24, Part VI.

not have received for it anything approaching the par value of the stock. In such cases the liability of the stockholder toward the corporation itself, in the absence of fraud, has been fully met, but the creditor of the corporation, if he cannot satisfy his claim out of the corporate assets, may sue to recover from the stockholders sums equal to the difference between the actual value of what they paid the corporation for its stock, and the par value of their shares. To illustrate: If stock that has a par value of \$100 per share is sold by the corporation for \$80 per share as full-paid and non-assessable, the corporation cannot subsequently demand the difference of \$20 of the stockholder, but the creditor of the corporation has a legal right to do so. When property or services have been given in payment for the stock, the corporation is entitled to exercise its judgment as to the reasonable value of the property or services received. When such stock is issued it is sometimes hard to prove that the stock is not full paid. Stock of this character, that has been issued without the receipt of an adequate supporting value by the corporation, is commonly called *watered stock*. In several of the states the directors, whose duty it is to issue stock, are made personally liable, not only to the creditors, but also to the corporation for the issuance of part-paid stock.³

A stockholder who is not the original subscriber, but who has purchased stock for which the full par value was not paid, and the stock is marked full paid and non-assessable, is not liable to creditors for the unpaid balance if he has no knowledge of the fact that it was not fully paid. The liability in such cases remains with the original subscriber, or is lost. If he has knowledge of the conditions under which it was issued he is liable.

Treasury Stock.—Stock that has once been issued as full paid and non-assessable, when acquired by the issuing

³ See the Laws of Vermont and New York.

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corporation by purchase, gift, bequest or exchange, is called *treasury stock*. Only in those states that permit a corporation to own its own securities is it possible to have treasury stock.⁴ Such stock, when again sold by the corporation for less than its par value, does not impose upon the purchaser a liability as in case of part-paid stock. This holds even as between the purchaser and the creditor of the corporation. This principle is frequently taken advantage of in forming mining corporations. The owner or owners of a mining claim will form a corporation and exchange the claim for all of the corporation's capital stock. In order to secure additional funds for development purposes, a large block of the stock is given back to the corporation, which sells it for what it will bring. It is quite obvious that this practice, where permitted under state laws, makes a mere fiction of full paid stock.

Stock Classification. — It is frequently deemed desirable by the incorporators to provide for several classes of stock. The bases of classifications of this kind are the risk factor assumed by the stockholder and the degree of control that he exercises. A very common arrangement is to provide for two classes in the charter, namely, common stock and preferred stock.

COMMON STOCK

The securities that vest in their holder title to the otherwise unencumbered or unpledged income and assets of the corporation, are called its *common stock*. Attendant upon its ownership is the assumption of the first risk of loss, arising from the fact that the holders of other securities of the corporation are given a preferred claim on income, and usually also on assets. The common stockholder's interest in the business of the corporation is thus in the nature of a final equity coupled with power of control.

⁴ The laws of Missouri do not permit the corporation to own its own securities.

Rights of the Common Stockholder.—The characteristics of common stock are perhaps best brought out by a consideration of the rights that become vested in a person by virtue of the ownership of a share of such stock. These include the following:

(a) *Voice in direction.* For each share of common stock held by him, the stockholder is entitled to cast one vote on each proposition laid before the general body of stockholders, be it the election of directors or the determination of some financial or other policy. This voice in the direction of the corporation is a right inherent in the entrepreneur and is alienable only with his consent. The right to vote may be exercised in person or may be delegated to another by execution of a power of attorney, called a *proxy*.

(b) *Notice of meetings of stockholders.* To make effective his right to vote, the stockholder has furthermore the right to be notified of the time, place and purpose of meetings of the body of stockholders.

(c) *Information.* As an entrepreneur, the common stockholder is entitled to inform himself of the condition of the business. He has the right to demand such financial and other reports as may be prescribed in the state laws, or in the charter and by-laws of the corporation. In addition to this, he has a limited right to inspect the books of the corporation. Under common-law rules this last was an absolute right, but in modern practice it is generally limited to prevent the stockholder from interfering with the conduct of the business and from exercising the privilege for purposes other than of informing himself of the condition of the business. The reason for this restriction is obvious. If it were not imposed, what would prevent an officer of a competing corporation from purchasing a share of stock of his competitor and thereby enjoying the privilege of informing himself as to amount of its business,

the location and names of its customers, etc.? The courts, in enforcing this right, usually look into the motive behind it rather than to the bare right itself.

(d) *Right to participate in profits.* That part of the income of the business that remains as a surplus after all expenses and current creditors' claims have been paid and sufficient funds to keep up the assets of the business have been set aside, is ordinarily considered to be the net profit. This, in the corporation, belongs to the stockholders to be distributed on the basis of shares owned. The common stockholder has a claim on these profits only to the extent to which they remain unpledged to other stockholders. The distribution of the profits can take place only by the declaration of *dividends* by the directors, but when dividends have once been declared the stockholder has a right to demand and to receive them from the corporation. They may not be withheld from him. Thus the right of the common stockholder to dividends, while it cannot be denied, is contingent upon the satisfaction of all prior or preferred rights.

(e) *Right freely to dispose of shares.* Since one of the inherent characteristics of securities is that they are freely transferable, the common stockholder enjoys the right to sell, give, devise or bequeath his shares of stock to another. Such a transfer carries with it all rights, privileges and preferences enjoyed by the transferer by virtue of ownership of shares.

The Stockholder's Liability.—The liability arising out of the ownership of stock of a corporation has been indicated here and there. It may be well at this point to summarize it.

1. His liability is limited and is easily measured.
2. He may lose up to the par value of stock subscribed for and purchased or what he has actually paid for non-par value stock.

3. He may be called upon to pay to the creditors of the corporation the unpaid balance on part-paid stock.
4. He may be called upon to pay to the creditors a sum equal to the par value of the stock that he holds if he holds stock in national or state banks.
5. He can be forced to reimburse the corporation or its creditors for any dividends paid out of assets or declared when the corporation was insolvent.
6. He is liable, in most states, for his proportionate share of wages owed to employees in case of insolvency.

Classification of Common Stock.—Although not very general, classification of common stock is sometimes resorted to. For example, two classes might be made, Class A consisting of a given number of shares and entitled to elect two members to the board of directors, and Class B entitled to elect but one member to the board of directors. Such classifications are frequently employed to insure control on the same basis that existed in a partnership when it is transformed into a corporation to secure the advantage of the latter form of organization. Classification of common stock by large corporations is extremely rare as it tends to give a preference that can be better and more minutely expressed by means of preferred stock.

PREFERRED STOCK

Stock that is distinguished from the common stock of the same corporation by conferring upon the holder special or preferred rights, not enjoyed by the common stockholder, is called *preferred stock*. It is the generally accepted rule that preferred stock vests in the holder all of the rights that he would possess as a common stockholder, and in addition thereto such rights and privileges as are specifically conferred, together with such restrictions as may be imposed upon him under the charter provisions creating

the class of preferred stock that he owns. It is essentially common stock with certain definitely described privileges and restrictions added.

From what has been said of the rights of the common stockholder, it is plain that a great many varieties of preferred stock can be brought into use. However, in practice this does not seem to have been the general result. A few more or less standardized types, based quite largely upon preference as to dividends and assets, have been widely used; but only occasionally are types with distinctive features other than these found. The following examples of preferences and restrictions, while by no means exhaustive, indicate the characteristics of the more common types of preferred stock.

Preference as to Dividends. — Preferred stock may be given preference as to dividends alone by some such clause as this: "The holders of the preferred stock shall be entitled to receive, when and as declared, from the surplus or net profits of the corporation dividends at the rate of seven per centum and no more." Such stock possesses three distinctive features; first, its holder must receive dividends before the common stockholder is entitled to any; second, the dividend must be equal to seven per cent of the par value of the stock, and third, it cannot exceed seven per cent even though enough profits remain to declare dividends of more than seven per cent on common stock. Furthermore, the directors are under no obligation to declare dividends annually, but may allow earnings to accumulate so that when dividends are declared the common stockholder may receive far more than the preferred stockholder.

If, however, the word "annual" be inserted before the word "dividends," the result would be to require the directors to declare dividends annually, if earned, and the preferred stockholder should under good management receive his seven per cent annually.

If a further change is made by striking out the words "and no more," the seven per cent would become a minimum instead of a maximum dividend rate, and the preferred stockholder would participate in dividends if the net earnings permitted of a dividend of more than seven per cent on both preferred and common stock. Both classes would receive the same rate in that case. Thus the words "and no more" make it *non-participating* preferred stock.

Frequently it is found desirable to assure the preferred stockholder of a specified annual rate of dividend on the par value of his stock by providing that "if in any year the stipulated dividend rate shall not have been paid, the deficiency shall be payable before any dividends shall be paid or set apart for the common stock." In other words, the preferred stockholder's claim to a stipulated dividend on his stock does not run from year to year, but if not satisfied in any year carries over from one year to the next and so on until it is finally paid. This type of preferred stock is called *cumulative*.

Preference as to Assets. — Preference to share in assets upon dissolution of the corporation is frequently given to preferred stock, particularly to the cumulative type. The two preferences combined make a very useful stock because of the relative ease with which it can be sold on the market or be given in exchange for properties or stocks of corporations that are to be consolidated or combined.

Voting Power. — Preferred stock is frequently denied the right to vote on the theory that the preference granted is sufficient to compensate the holder for giving up his right of control. Frequently a contingent voting power is conferred, by which the preferred stockholders are empowered to supplant the common stockholders in the control of the corporation whenever the earnings are insufficient to pay the preferred dividends in full. The control then remains in the hands of the preferred stockholders until all ac-

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cumulated dividends have been paid, when it reverts to the common stockholder. In other cases, the preferred stockholders are given the right to elect a certain number of members to the board of directors, for example, one or two of a board of five. Still another arrangement that is sometimes resorted to, is to give each of the two classes of common and preferred stock equal voting power, regardless of the number of shares of each that are outstanding. It may also be provided that no mortgage or other encumbrance shall be created without the consent of a substantial majority of the outstanding preferred stock.

Other Features.—Incorporators frequently provide for the issue of preferred stock as a temporary loan. In such cases it is issued with the proviso that it may, at the will of the directors or common stockholders, be redeemed or retired by the corporation upon payment of the par value, plus ten to fifteen per cent, and all accrued dividends. A sinking fund based on a percentage of the par value of the outstanding preferred stock, may be provided for purposes of redemption. This type is called *redeemable preferred stock*, and also frequently *debenture stock*, as in the General Motors Company.

Another practice is to issue it subject to conversion into any other security, such as bonds or common stock, that may be considered more attractive to the investor. Such stock is known as *convertible stock*.

Preferred Stock of No Par Value.—While stock without par value is usually common stock, it is permitted, under the laws of a few states, to issue preferred stock without par value. This has been made possible only within the last few years, and as yet little of this type of stock has been employed in corporate capitalizations.⁵

⁵ Descriptions of examples of preferred stock actually in use that combine one or more of the features described above are given in Part VI, in Forms 19 to 23, and should be carefully studied by the student so that he may familiarize himself with the way in which these features are combined in practice.

Founders' Shares. — In England a special kind of preferred stock known as "founders' shares" has been frequently employed in order to favor those who launch, or are among the first to invest in, the new corporate enterprise. The preference given the holders of founders' shares is usually based on a given per cent of the sum total of net earnings available for distribution as dividends on common stock. For example, a corporation with an authorized capital stock of \$500,000 has \$150,000 in preferred stock and \$350,000 in common stock. Of the latter, \$50,000 are in founders' shares the holders of which are entitled to receive one-third or one-half of the distributable net-profits remaining after every class of security-holders, other than common stockholders, has been satisfied. In the United States little use has been made of this type of security. The reason for this is twofold. In the first place, the same classification of security-holders may be secured by means of carefully selected types of preferred stock, and secondly, the laws of our states have not been sufficiently interpreted by the courts to insure the validity of issues of founders' shares. The laws of New Jersey and many other states, however, would seem to permit of their use, and at least one large corporation, the United Retail Stores Company, organized within the past few years has employed founders' shares with considerable success. Founders' shares are frequently made redeemable. This practice is common in France.

BONDS AND CORPORATE NOTES

The corporate bond is a security to which attaches a creditor's interest in the corporation carrying with it a claim on income and property. It is distinguishable from stock, in that its holder ordinarily exercises no control through voting power over the business so long as the corporation meets its obligations to him as they fall due.

The risk of loss assumed by the bondholder is, in theory, and usually in practice, relatively less than that assumed by the stockholder; but, as the intensity of this factor is dependent upon the nature of the support back of the interest and principal of the loan, here the same characteristic of gradation as found in preferred stock also applies. Thus, while in principle, a clear distinction or line of cleavage is seen to differentiate bonds from stocks in the matter of claim on income, risk assumed and control exercised by the holder, in practice these distinctions are reduced from the absolute to the relative. The result is the existence of a serrated scale of securities, ranging from common stock at one end to mortgage bonds at the other, permitting of all degrees of differentiation in respect to claims on income and assets, risk and control.

Structural Elements of the Bond.—In order to understand clearly just what place the bond occupies among the corporate securities and what rights, privileges and powers the bondholder enjoys in the corporation, it will be necessary to analyze the elements that determine the character of any bond. Five such structural elements enter into the construction of every bond, namely, (1) the nature of the covenant creating the bondholder's claim on income and assets; (2) the nature of the supporting value back of the principal; (3) the manner in which payment of interest and principal is to be made; (4) the nature of the power of foreclosure and assumption of control, and (5) the purpose for which the bond has been issued.

By no means is each of the enumerated elements employed in the building of every bond in exactly the same way, or with the same degree of importance or emphasis. From this it follows that the variety of bonds that may be issued is exceedingly great; but as in the case of preferred stock, the bond issues have in practice been quite largely confined to a few more or less common types, a factor

that favorably influences their vendibility. The possibilities in the matter of varieties of each well recognized type are made apparent through a brief explanation of the elements that have been enumerated above.

1. The covenant creating the bondholder's claim on the income and assets of the corporation is a legal instrument called the *indenture*. Broadly speaking, there are two classes of bond indentures, namely, the *mortgage deed of trust* and the *debenture*, each of which gives name to a class of bonds.

If the covenant is in the nature of a mortgage it conveys title to the property supporting the bond issue to a trustee, to be held by him in trust for the benefit of the bondholders who become the beneficiaries. The stockholders, however, retain their power of control over the corporation, which remains in full possession and enjoyment of the property as long as the claims of the bondholders are faithfully and regularly satisfied. In addition to containing sections on these points, the covenant also contains an introduction giving the names of the parties and the legal status of the corporation, together with a recital of its authority to incur bonded indebtedness, and also sections describing the bond certificate, rate of interest, date of redemption, and in the fullest detail, the property that is pledged in support of the mortgage, requirements as to insurance of this property; a statement of the securities of subsidiaries, if there are any, and a section dealing with foreclosure and control in case of default. Some of these mortgage trust deeds attain considerable length, especially in the case of railroad corporations, some of whose indentures would make a fair sized book if printed and bound.

The debenture, unlike the mortgage bond, does not convey in trust any specific property of the corporation, but is very much like an unsecured promissory note. The holders

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of debenture bonds, thus, in so far as their claim on the assets of the corporation in case of insolvency is concerned, are on the same level as general creditors. They have been little used in this country, but constitute the chief type of creditor securities issued by the English railway companies.

2. The nature of the supporting value back of the principal of the loan is, in final analysis, the determinant of the real value of the bond. In the case of the mortgage bond the supporting value is the real and personal property specifically described in the deed of trust. When it includes all of the property of the corporation the bond is called a *general mortgage bond*, and when but a part of it, as for example a single division of a railroad or a freight or passenger terminal, it is a *special mortgage bond*. The amount of property pledged is also important; if it is fixed, it limits the amount of bonds that may be issued, and if it is permitted to bring additional property under the mortgage, the bond issue may be extended. Out of this feature, coupled with variations in the method of issue, spring three types of mortgages; (1) the *closed*, under which the amount of bonds is fixed and all must be issued at one and the same time; (2) the *open-end*, authorizing an indefinite amount of bonds to be issued as needed under certain restrictions, and (3) the *limited open-end*, authorizing a maximum amount of bonds but permitting them to be issued as needed. The first and third are quite common with railroads and industrials, while the second type has been used at times — but infrequently — by railroads.

When the supporting value consists solely of the securities of other corporations the bonds are called *collateral trust bonds*; when of equipment, such as the rolling stock of railroads, *equipment trust bonds*; and if they are issued to secure money to purchase property, and are to be secured by the property to be bought, they are *purchase-money bonds*. Sometimes, however, the supporting value

is not specifically designated, as in the debenture, in which case no preferred claim on the property of the corporation vests in the bondholder. Several issues of bonds may be supported by the same property in which case they are designated as "first" or "second" mortgage bonds.

3. The manner in which payment of the interest and principal is to be made is also a factor determining the character of the bond. Upon it depends the procedure that the corporation is obliged to follow in meeting its bonded debts.

The rate of return, or earning power of the bonds, is the rate of interest that it bears. This is usually expressed as a fixed per cent of the amount of the principal. Due to the relatively lighter risk of loss assumed by the bondholder, this rate is ordinarily less than the prescribed dividend rate of preferred stock. While the latter is commonly set at seven or eight per cent of the par value, the former is most frequently five or six per cent per annum. It constitutes a fixed charge against the income of the corporation, and except in the case of income bonds, it may not be carried over from year to year but must be paid when it falls due. The rate is usually an annual rate, but payment is in semi-annual or by other time installments. Bonds may be made *participating* by providing that any income, more than sufficient to pay the interest on the bond and a like dividend on stock, shall be distributed on an equal percentage basis to the two classes of security holders.

The principal is the sum total of the outstanding bonds, each bond being a fractional part of this amount expressed in terms of money. The principal represented by a single bond is more frequently \$1,000 than any other sum. Two methods of payment are in use, the *sinking fund* and the *serial*. Under the former the entire issue of bonds must be redeemed at the expiration of the fixed term of years for which the loan runs, but frequently the issue may be re-

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deemed in part at a premium at the option of the directors of the corporation upon due notice to the bondholder. Under the serial plan the maximum time limit of the loan is fixed and regular redemption dates fixed so that the entire issue will be redeemed in equal installments, the last on the expiration date. Thus, we may have serial bonds issued for a ten-year period, one-tenth to be redeemed at the expiration of each year. The bonds that are to be paid are chosen by lot. Bonds are *profit-sharing* when the bondholder is entitled to a share of the increase in value of the pledged property accruing during the life period of the bond.

The interest and principal may be made payable in gold in which case the bond is called a *gold bond*.

4. The power of foreclosure and the assumption of control may become exercisable by the bondholder under several conditions, the most important being the failure of the corporation to pay the interest on the bonds as due, and its failure to pay the principal at the expiration of the loan. Under most mortgage bond indentures, foreclosure may be had upon the advent of either of the two contingencies, and the same thing applies generally to debenture bonds. In the case of income bonds, however, the lapse of an interest payment does not give the bondholder the right to exercise this power but he may do so only on failure to pay the principal. This is so because the only support back of the interest of the income bond is the annual income of the corporation, while in the mortgage bond it is the mortgaged property which in both cases also supports the principal.

In most bond indentures is inserted a provision granting the corporation a period of grace in which to make payment of interest and principal before the bond holders take over the control. This period is most frequently the same

as the regular dividend interval, that is to say, six months.⁶

When the bondholders take over the control the stockholders usually step out and appoint a committee to look after their interests. It is customary for the bondholders to buy the property of the corporation when this is sold at auction to meet the debts. Another course of procedure is to reorganize the corporation by means of readjusting its capital in such a way as to reduce the amount of outstanding securities. This results in either dropping the common stockholders or in materially reducing their holdings.

5. The purpose for which the bond is issued frequently gives name to the issue. Thus, we find "refunding," "construction," "unifying," "extension," "improvement," "consolidated" bonds, etc.

Short Time Notes.—It sometimes happens that the corporation may be temporarily in need of funds; or that, while a bond issue is necessary, the money market is not favorable for its sale. In such cases corporations frequently resort to the issuance of short time notes which have all the characteristics of the money paper or notes issued by proprietors of personally owned businesses. These short time notes, while they are not, strictly speaking, securities, differ only in the length of time that they run—usually from six months to three years—from debentures. Consequently they are now often included under that term. Unusually large quantities of such notes were issued from 1918 to 1920, due to stringent money conditions that made bond issues too costly.⁷

⁶ In Part VI, in Forms 27 and 28, are given brief descriptions of some representative types of bonds which the student should study carefully.

⁷ See table on page 91 showing new securities issued in the United States.

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USE OF SECURITIES

Classes of Securities Ordinarily Used.—It has thus far become apparent that a vast variety of securities may be created through the use of minute differentiations in the characteristics of the several major classes. This possibility naturally makes the corporation an extremely flexible form of ownership organization. However, American corporations seldom employ more than two or three classes of stock. This is not so generally true of bonds, particularly with our railroads, where successive hypothecation of the property in whole or in part is the general rule, and where it is also common practice to retire one bond issue out of the proceeds of another. A few examples will serve to illustrate these points.

The consolidated balance sheet (1919) of the United States Steel Corporation, which owns a great many subsidiary corporations, shows that the Steel Corporation itself had outstanding on December 31, 1919,

Common Stock	\$508,302,500
Preferred Stock (7% Cumulative).....	360,281,100
U. S. Steel 50 yr. 5% Bonds	230,709,000
U. S. Steel 10-60 yr. 5% Bonds	176,393,000
Bonds of Subsidiaries guaranteed by U. S. Steel— (12 issues)	99,227,000

But in addition to the above, the subsidiaries themselves had outstanding \$431,342.50 in several classes of stock and \$62,398,931.53 in bonds comprising some 33 individual issues.

The Southern Pacific Railroad had outstanding on December 31, 1919,

1. Common Stock	\$160,000,000
2. S. P. R. R. Co. First Refund Gold 4's.*...	143,831,500
3. S. P. Branch Ry. First Gold 4's	3,533,000

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4. S. P. R. R. (of Cal.) First Consol. Gold 5's	4,127,500
5. Northern Railway First Gold 5's	4,751,000
6. Northern California Ry. First Gold 5's....	1,074,000
7. Coast Line Ry. First 6's	700,000

(The star indicates that these bonds were issued largely to supplant outstanding prior issues.)

The practice of using a multiple classification of stock is perhaps more common in England than in any other country of the world. For example, Lever Brothers, Ltd., incorporated in Great Britain in 1894, is authorized to issue the following classes of stock:

1. £ 4,000,000 — 5% Cumulative First Preference
2. £ 6,000,000 — 6% Cumulative " A " Preference
3. £10,000,000 — * " B " Preference
4. £10,000,000 — * " C " Preference
5. £10,000,000 — 15% Cumulative Preferred Ordinary
6. £10,000,000 — 15% Cumulative " A " Preferred Ordinary
7. £10,000,000 — 20% Cumulative Preferred Ordinary
8. £10,000,000 — 20% Cumulative " A " Preferred Ordinary
9. £10,000,000 — 20% Cumulative " B " Preferred Ordinary
10. £10,000,000 — 5% Cumulative Preferred Ordinary
11. £10,000,000 — Ordinary.

(The stars indicate that the per cent of dividend is left for determination at time of issue.)

While these are representative examples of very large corporations, they are nevertheless typical illustrations of the use of various classes of securities. But hundreds of examples of smaller corporations might be cited where but a single class of stock and no bonds are used.

Capitalization. — The term "capitalization" as currently used with reference to corporations, presents a variety of meanings. Some writers on corporation finance define it as the face or par value of the stocks and bonds of the corporation. This definition, however, neglects to

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take into account that stock may be issued without par value, and also that not all of the securities authorized may actually have been issued and placed in the hands of persons who will give effect to their claim on income and assets. A better definition of capitalization is the total amount, at par value, of the securities issued by the corporation plus the sum actually received by it for non-par value shares outstanding. This may be more briefly stated as "the obligation assumed by the corporation that arises from issued securities."

A few examples will serve to make this definition clear.

Case I. Where the corporation receives the full par value of the securities issued.⁸

Securities Issued	Value Received
5,000 shares common stock	\$500,000
2,500 shares preferred stock	250,000
250 Bonds @ \$1,000 each	250,000
	<u>\$1,000,000</u>

In this case the capitalization equals the value received by the corporation in payment for its securities.

Case II. Where the corporation receives less than the full par value for securities issued.

Securities Issued	Value Received
2,500 shares common stock }	\$500,000
5,000 shares preferred stock }	
250 Bonds @ \$1,000 each	250,000
	<u>\$750,000</u>

Here the common practice of giving away common stock with each share of preferred issued, has been followed. For two shares of preferred issued, a bonus of one share

⁸ Unless otherwise stated the par value of stocks is assumed to be \$100 per share.

of common stock has been given the subscriber. As a result, a total of \$750,000 in stock, at par, has been issued for \$500,000, while the bonds have been sold at par. The capitalization of the corporation is, in this case, \$1,000,000 while the value received by it is but \$750,000. Under these conditions the stock is said to be "watered." If the preferred stock has preference as to assets as well as dividends the equity of the common stockholders in the property of the corporation is practically nothing and the value of the stock will be determined largely by its power to control the business policies.

Case III. Where stock without par value is employed.

Securities Issued	Value Received
2,500 shares without par value	\$100,000
5,000 shares preferred stock	500,000
250 Bonds @ \$1,000 each	250,000
	\$850,000

The capitalization in this case would be \$850,000, a sum exceeding the par value of the securities issued by \$100,000 which is the amount actually received for non-par value stock. If the non-par value common stock has been given away, the capitalization would be reduced by \$100,000, but it would still be an obligation assumed by the corporation, although it would have practically no equity in the property.

Securities can, of course, also be issued for more than their par value in which case the difference between the capitalization and the assets constitutes surplus.

The capitalization must appear on the balance sheet of the corporation on the liabilities side, balanced by assets. When non-par value stock only is issued, the offset for the stock liability is the sum or value received for it. The same is true in case full value is received for par value securities. But if par value securities have been issued

for less than their par, this value must be inflated to make assets equal the liabilities. This inflation is taken care of in several ways. A much greater value than their real worth may be ascribed to the business plant and equipment, or items such as "patents," "rights," "franchises" or "good-will" may be inserted among the assets. The latter is the better accounting practice, because it indicates at a glance that the corporation has not received in tangible assets a value equal to the securities that it has issued. Such a condition does not necessarily indicate over-capitalization, for it may be that the intangible assets of patents, good-will, etc., are more than sufficient to make up the difference. This is well illustrated by the value of such patents as the telephone and such trade marks as "Unedea" and "Wrigley's." Still a third method of handling an apparent excess capitalization of this character is to enter an item such as "discount on stock" or "discount on bonds" among the assets, but this is infrequently encountered in practice.

The following condensed balance sheet of the American Milling Company illustrates remarkably well the inflation of assets to offset capitalization. In 1912 patents, good-will, etc., were entered as worth \$2,437,521 while in 1914 no value whatever is ascribed to them. It had originally been inserted to inflate the assets. The reason for dropping the item from the balance sheet may be found by a comparison of the capital stock items under liabilities for the two years. The outstanding capital stock has been reduced by \$2,795,576.

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AMERICAN MILLING COMPANY

ASSETS	1914	1912
Real Estate, Buildings, Machinery, etc. \$	964,057	\$1,013,039
Investments	465	1,340
Patents, good-will, etc.	—	2,437,521
Deferred charges to expense	5,818	11,696
Profit and loss deficit	—	194,441
Linseed business	—	242,146
Current assets	110,977	266,845
Total assets	<u>\$1,081,317</u>	<u>\$4,167,028</u>
LIABILITIES		
Capital stock	\$ 698,894	\$3,494,470
Bonded debt	139,000	128,000
Profit and loss surplus	108,260	—
Reserves	3,418	9,172
Current liabilities	131,745	535,386
Total liabilities	<u>\$1,081,317</u>	<u>\$4,167,028</u>

The total capitalization of the American railways for which complete statistics are available, will throw some additional light upon the general use of the several classes of securities common to this country. The following table shows the capitalization of all operating railways and their non-operating subsidiaries, but excludes switching and terminal companies.

CAPITALIZATION OF RAILWAYS IN THE UNITED STATES ON DECEMBER 31, 1918

*(Thirty-second Annual Report on the Statistics of Railways
in the United States)*

	Actually Ownership Securities out-standing	Held by or for company	Totals
Common Stock ...	\$7,052,291,302	\$197,015,979	\$7,249,307,281
Preferred Stock...	1,794,425,212	11,384,543	1,805,809,755
Total Stock	<u>\$8,846,716,514</u>	<u>\$208,400,522</u>	<u>\$9,055,117,036</u>

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Creditor Securities

Mortgage bonds.	\$8,108,695,075	\$1,007,224,563	\$9,115,919,638
Collateral trust bonds	849,716,189	27,187,120	876,903,309
Income bonds ..	333,986,190	19,117,720	353,103,910
Miscellaneous ..	993,242,271	18,885,850	1,012,128,121
Equipment Bonds	320,916,764	50,744,063	371,660,827
Total Bonds .	\$10,606,556,489	\$1,123,159,316	\$11,729,715,805

TOTAL CAPITAL-

IZATION	\$19,453,273,003	\$1,331,559,838	\$20,784,832,841
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The extravagant use of creditor securities is characteristic of our railways. In this respect they differ considerably from most industrial concerns who follow a more conservative policy with regard to funded debt.

Over-Capitalization. — Over-capitalization of a corporation is that state in which the earnings of the corporation are for a period of years, more or less, consistently inadequate to meet the current claims of its security holders on its income. These claims are charges against the earnings of the corporation. In the case of bonds they are usually fixed and not deferrable; for preferred stock fixed but deferrable, and for common stock contingent upon earnings. The income of the corporation in turn is dependent not only upon the earning power of the tangible and intangible assets that it employs in its business, but also upon the efficiency of its managers and the financial policies of the entrepreneurs. To insufficient assets coupled with too much optimism regarding future earning power, may be attributed most cases of over-capitalization that have been so conspicuous in the corporation annals of this country.

In the following table are shown some of the more prominent examples of over-capitalization.⁹

⁹ The data relating to the United States Steel Corporation is taken from Ripley, *Trusts, Pools and Corporations* and, for the other four corporations, from Dewing, *Corporate Promotions and Reorganizations*.

Kinds of securities making up the capitalization	National Starch Co.	Glucose Sugar Ref. Co.	United States Realty and Construction Co.	United States Shipbldg. Co.	United States Steel Corp.
Bonds.....	\$3,837,000			\$24,500,000	\$384,413,680
Preferred stock, 1st.....	2,219,400	\$13,639,300	\$27,500,000	20,000,000	510,205,743
Preferred stock, 2d.....	1,846,800				
Common stock.....	4,450,700	24,027,300	33,500,000	25,000,000	508,227,394
Capitalization.....	12,353,900	37,666,600	61,000,000	69,500,000	1,402,846,817
Estimated assets.....	3,750,000	3,750,000	22,000,000	16,000,000	793,000,000

If the earnings are sufficient to pay the claims of all security holders except the common stockholders, it would not be a bad case of over-capitalization; and the common stock would have a value based on possible dividends. But if the earnings suffice to pay only interest on the bonds and part of the preferred stock dividend, allowing the unpaid portion to accumulate, the case is much more serious. This will eventually necessitate a reorganization of the corporation in such a way as to reduce the amount of outstanding securities. When the corporation cannot pay the interest or principal on its bonds when due the result is insolvency and receivership necessitating a forced reorganization or a complete winding up of the business. In all of the examples given above with the exception of the United States Steel Corporation, over-capitalization resulted eventually in voluntary or forced reorganization. The United States Steel Corporation adopted the policy of putting its earnings back into plant and equipment and in this way built up its assets until they today exceed in value the sum of its outstanding securities.

A further study of the corporate securities, their uses, advantages and disadvantages, as well as their relation to capitalization and the financial policies of corporations, cannot be undertaken in this work. These aspects of corporate organization are specifically treated in standard works on corporation finance.

CHAPTER IX

THE CORPORATION — FORMATION, CHARTER AND BY-LAWS

THE lack of uniformity in the corporation laws of the several states of this country, together with the annoying frequency with which these laws are modified, or repealed and redrafted by the state legislature, makes it next to impossible to lay down any general rules of procedure that must be followed in forming a corporation. There are almost as many variations as there are states, and each year sees new requirements introduced and old discarded ones resurrected. If the student is especially interested in the prescribed procedure of any particular state, he must consult its latest revised statutes. The only practical presentation of this subject for the student of general business organization must be in the nature of a general composite of the legal requirements as found in statutes of the states, supplemented here and there with notations calling attention to more or less marked deviations from these general principles.

General and Special Corporation Laws.—In the preceding chapter it was pointed out that the early corporations were created by special act of the state legislature. This method of formation was finally abandoned when the state of Rhode Island, in 1892, amended its constitution, providing for incorporation under *general corporation laws*. Today such general corporation laws have been adopted by every state. Some of these laws lay down uniform, general rules governing the formation of all types of corporations, with the exception of municipal corpora-

tions; others apply to business corporations generally, while still others to only certain types of business corporations. The present-day tendency is to confine the applicability of general corporation laws to all business corporations that are not engaged in rendering a public service, banking, insurance and the like. This narrowing of the scope of such general laws appears to follow a line whose determination rests upon the existence in the enterprise of a special public interest that can be adequately safeguarded only by closer regulation and control afforded by special laws. Thus, we find in most states public service commissions, state bank and insurance commissioners, etc., who are vested with special regulatory power, as well as with the duty of supervising the formation and operation of corporations engaged in special fields of enterprise.¹

This scheme of general and special corporation laws is well illustrated by the "Business Corporation Law" adopted by the state of New Hampshire, in 1919. Under this law may be formed any corporation for the purpose of carrying on any lawful business except banking, the construction and maintenance of railroads, insurance, the business of making contracts for the payment of money at a fixed date or upon the happening upon some contingency, or the business of a trust company, surety or indemnity company, a safe deposit company, or a trading stamp company, or the business of issuing, selling or redeeming trading stamps, coupons, tickets or other similar devices.

FORMATION OF BUSINESS CORPORATIONS

The work of forming a business corporation begins with the decision on the part of the persons interested to form

¹ In New York, Alabama, and several other states the term "corporation" is construed to include all joint stock companies, and associations having any of the powers or privileges of corporations not possessed by individuals or partners. This would include legal entity, limited liability and the power to issue securities.

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a corporation to operate a business undertaking, and ends when the corporation is in a position to begin business. It, therefore, includes such items as (1) who may incorporate, (2) pre-incorporation agreement, (3) application for charter, (4) certification and recording of articles of incorporation and (5) the organization meetings of stockholders and directors. The more common method of procedure is that here outlined, but in a few states, among them Maine, Massachusetts, Missouri and New Hampshire, the order is practically reversed.

Who May Incorporate.—The business corporation must, as a general rule, be formed by natural persons of lawful age and legally competent. The qualifications of incorporators, other than this, vary greatly from state to state. Requirements such as the following are common: that at least two-thirds of the incorporators shall be citizens of the United States, and that at least one must be a resident of the state of incorporation. This is the New York provision. The number of incorporators is also limited by law, usually to a minimum of three, but the maximum number varies greatly. In practice, chiefly as a matter of convenience, the minimum number of incorporators is most frequently used.

Pre-Incorporation Agreement.—Naturally, those who desire to form a corporation must agree among themselves to incorporate for a particular purpose. Such an agreement is in the nature of a partnership agreement and incorporators are treated as partners until the process of formation is complete.

Application for a Charter.—The incorporators then meet to draw up the charter application. This should conform in every respect to the requirements of the state laws. A complete application must include (1) a draft of the powers, and privileges that the incorporators desire to have granted by the state to the proposed corporation, (2) the

tender in payment of all organization taxes and fees, and (3) such other documents as may be required under the laws of the state.

The draft of powers, privileges, etc., should be very carefully prepared, as this, when granted, becomes the charter, or articles of incorporation. Requirements as to the contents of this document are in most states very explicit. It must commonly set forth: the name of the corporation; the purpose for which it is formed; the place where its principal business is to be transacted; the term for which it is to exist; the number of directors; the amount of capital stock and the number of shares into which it is divided; the amount of capital stock actually subscribed and by whom, and such special provisions, consistent with the laws of the state, as the incorporators may desire to include.

The other documents frequently required are such as relate to the consideration that the prospective corporation is to receive from the original subscribers in payment for its stock. Thus, where real estate has been pledged as consideration for stock, it must be clearly identified by metes and bounds and the value at which it is accepted by the corporation stated.

Where there is a requirement that a certain per cent of the capital stock must be subscribed to and actually paid in, a trustee, to whom such payments are made, is appointed to serve until the corporation has been fully organized. He then turns over the consideration he has received to it. In Kansas, twenty per cent of the capital stock must be subscribed to and paid in; in Missouri, fifty per cent. The same provision is also found in other states.

All documents are then taken before some state or county officer where they are subscribed to by the incorporators and acknowledged and signed. Such officers must frequently qualify as authorized to take and certify acknowledgments of real property, such as deeds.

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The application, having been properly prepared and acknowledged, is then filed with the clerk, or recorder, of the county in which the corporation was formed, or with the Secretary of State of the state of incorporation, and in some states with the Attorney-General.

The organization taxes and fees that must be paid are the following:

(1) A charter tax—usually based on the amount of capital stock authorized.

(2) Fees to the Secretary of State for filing and recording.

(3) Fees to the county clerk or recorder of deeds, for filing and recording.

The fees are uniformly small, but the charter taxes show great variations from insignificant sums to amounts that are very large, as the following table will show.

CORPORATION FRANCHISE TAXES OF SELECTED STATES, 1919

State of	On authorized capital stock of		
	\$250,000	\$1,000,000	\$10,000,00
Alabama.....	\$250	\$1,000	\$10,000
Colorado.....	60	210	2,010
Idaho.....	60	100	150
Kansas.....	175	550	5,050
Missouri.....	150	525	5,025
New Jersey.....	50	200	2,000
New Hampshire.....	100	250	1,150
New York.....	250	1,000	10,000
Oregon.....	45	75	750
West Virginia.....	190	340	475

Certification and Recording of the Charter.—The state or county officer to whom the documents are submitted causes them to be carefully examined to assure himself that they conform in every respect to the requirements of

law. The charter is then certified and preserved in the files or books of the office. Three certified copies are commonly made and distributed as follows: one to the incorporators for the corporation, one to the clerk or recorder of the county in which the main office of the corporation is located and one retained by the Secretary of State. Those copies that are kept on file in the offices of the public officials are open to inspection by the public, so that whoever deals with the corporation may know what its powers and privileges are.

Organization Meetings. — Notice of certification of the charter having been received by the incorporators, these must now proceed to effect a functioning organization. This may be done at the first meeting of stockholders and of the board of directors.

The first meeting of stockholders is usually assembled by bringing the incorporators together by means of a written call and waiver of notice, signed by all of the incorporators. The call should indicate the purpose and place of the meeting. The meeting is then called to order and organized by the election or appointment of a chairman and a secretary. The adoption of the charter and the framing and adoption of by-laws follow. This done, the stockholders proceed to elect the first board of directors, if these are not already named in the charter. In a number of the states, as in New York, the laws require that the directors for the first year must be named in the charter, which does away with the necessity of electing them at the first meeting of the stockholders. The next thing in order is the conclusion of the exchange of the corporate stock for property tendered the corporation for it. Such transactions, which amount to an acceptance of subscriptions to stock, must have express authorization of the stockholders, even as to price.

The first meeting of the board of directors ordinarily

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follows the first meeting of stockholders. At this meeting the directors first read the by-laws to familiarize themselves with their contents, particularly as to rules laid down for their own control and as to officers to be elected, their duties, etc. They then elect the officers of the corporation; adopt, or make provision for the adoption of a stock certificate; accept the subscriptions to stock by others than the original incorporators; formally exchange stock for property as instructed by the stockholders, fix the treasurer's bond, designate a bank as depository of funds, and attend to such other matters as may be brought before them.

The corporation is then ready to undertake business.

Reversed Procedure.—The "Business Corporation Laws" of New Hampshire (1919) furnish an excellent example of a prescribed procedure that is practically the reverse of the more frequently encountered form described above. The following brief description of this plan is taken from the *Corporation Journal*.² "Three or more persons may associate together to form a corporation. Any two of the first three persons signing the articles of agreement may call the first meeting of incorporators. At the organization meeting the incorporators effect an organization by the adoption of by-laws and by the election of a temporary clerk, a treasurer, a board of not less than three directors and such other officers as the by-laws may prescribe. The incorporators determine the amount of capital stock then to be issued and the consideration. The treasurer and the majority of the directors thereupon sign and make oath to the record of organization, which shall contain a true copy of the articles of agreement, the date of the organization meeting, the names and addresses of the officers and directors and the original or true copies of all votes passed authorizing the issuance of stock. The record

² *The Corporation Journal*, No. 89, Vol. III, pp. 362, 363.

of organization shall be submitted to the Attorney-General and, if it is in conformity to law, he shall so certify and endorse his approval thereon. The organization record shall, upon payment of the organization tax, be filed in the office of the Secretary of State, who thereupon issues a certificate of incorporation. The existence of every corporation begins upon the filing of the organization record in the office of the Secretary of State."

"Cut and Dried" Procedure.—While the procedure above outlined is in principle that required of law, in practice much of the work of actually forming the modern corporation is turned over to a law firm or some corporation that specializes in that service. In this way the whole procedure may be handled in a "cut and dried" way, relieving the incorporators of much tedious detail and routine. A tentative charter with "dummy" incorporators,—namely men who are employees of the law firm or organization company retained to organize the corporation,—may be employed. Thus, a complete "dummy" corporation may be set up and organized; whereupon, the charter is amended by substituting the real charter for the tentative one, and the "dummy" incorporators, officers, etc., are disposed of by transferring the stock to which they have subscribed to the real incorporators. This is the procedure that has been followed by many of our larger corporations, notably the United States Steel Corporation. A careful study of the charter of this corporation given in Part VI of the text will make this method of incorporation clear.

THE CHARTER

No uniform practice of nomenclature relative to this document is to be found in the state incorporation laws. In some of them it is designated as the *certificate of incorporation*, in others as the *articles of association* or *articles of incorporation* and in still others as the *charter*.

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The charter is to the corporation what the constitution is to the state, namely, a fundamental limitation upon its powers. Since the corporation may do only those things that it is specifically authorized to do, it is needless to point out the importance of the exercise of great care in framing its clauses. In drawing up a charter, it is not a question of obtaining from the state all the powers and privileges that may seem desirable, but rather the maximum that may be obtained within such restrictions as are imposed by the state constitution and the general or special incorporation laws. Powers in excess of such legal limitations, even though granted in the charter, are held by the courts to be non-operative. Again, powers, not granted in the charter, when exercised by the corporation, are held to be acts *ultra vires*, and are non-enforceable. These two considerations are the guides that the incorporators must follow in framing their charter.

The present-day policy of the courts in interpreting the charter powers of corporations, appears to have become much more inclined toward liberalism than in former years. The attitude taken is, that by granting a charter the state intended to create an artificial person capable of performing the purpose for which it was organized; and any slight deficiency in the charter which, if interpreted strictly, would prevent the proper functioning of the corporation, is now commonly held not to debar it. Nevertheless, it is always better to provide for all of the powers necessary in the charter.

Main Features and Provisions.—Most incorporation laws prescribe in general terms what the charter must set forth. Its contents, however, are by no means restricted to such requirements. In practically all cases the charter must contain brief statements on the points discussed below.³

³ The specimen charters given in Part VI should be carefully studied section by section in connection with discussion in the text.

1. Name of the Corporation. — Every corporation has a proprietary interest in its name just as it might have in a trade-mark or a grant of patent. Within the granting jurisdiction this name may not be assumed by any other corporation. This rule, however, has its exceptions. In Rhode Island and South Carolina a foreign corporation of the same name as a domestic corporation may be permitted to enter the state and to do business there. In the former state a domestic corporation may also, with the consent of an old corporation that is to be dissolved, assume the name of the latter. But these practices are, by no means, of general occurrence. In nearly all states the name must end with some word such as "company," "association," "corporation," or "limited." The purpose of this requirement is to protect those who do business with the corporation so that they may know the nature of the organization with which they are dealing.

2. Location of the Main Office. — In most of the states the laws require that the corporation shall establish and maintain its main office in the state that has granted the charter. At this office must be kept certain books and records. In many of the states, the meetings of stockholders and board of directors must be held there, and there must also be found in this office an agent, through whom any legal process or action against the corporation may be brought. Where required, the name of such resident agent is given in this section of the charter.

3. Object and Purpose. — The section of the charter defining the object and purpose of the corporation is of extreme importance. This cannot be changed at will as expedience may seem to dictate, and if it does not embrace all things contemplated, it may become a stumblingblock in the way of business expansion. The present-day tendency with respect to objects of the corporation is to make them as comprehensive as permissible, and in this way to

approach as nearly as possible the wide sphere of activity in business enjoyed by natural persons. A common practice is to divide this clause into three parts; the first describing in specific and general terms the nature of the business to be undertaken, the second, to give the corporation power to own and enjoy possession of real property, and the third to give it as nearly as possible the powers of a natural person. This is well illustrated by the following object clause for a mining and manufacturing corporation:⁴

1. To engage in mining of all kinds; manufacturing of all kinds; building of houses, structures, vessels, ships, boats, railroads, engines, cars or other equipment, wharves or docks, and to own and operate the same.
2. To lease, buy, sell, use and hold all property, real or personal, as may be necessary or convenient in connection with the said business.
3. To do any or all things set forth in this certificate as objects, purposes, powers or otherwise, to the same extent and as fully as natural persons might do and in any part of the world.

4. Capital Stock. — This clause gives the total amount of the capital stock that the corporation is authorized to issue, the classes into which it is divided and the rights that the holders of each class enjoy. When only par value stock is to be issued, the amount of the capital stock will be given as a stated sum, say, \$1,000,000. divided into 10,000 shares of the par value of \$100. per share. Then, if two classes, such as common and preferred stock, are to be used, the number of shares and the amount of each class is stated, together with a clear description of the rights of holders. When stock without par value is used, the number of such shares and the amount of the paid-in capital with

⁴ See also the special object clauses given in Part VI.

which the corporation is to commence business must be given. It is also possible to provide for both par value and non-par value stock, as well as for several classes of each kind. The classification of common stock, as for example into voting and non-voting, is not allowable in all of the states, but may be provided for in the by-laws by unanimous consent of the stockholders. Such classifications are frequently employed in reorganizing a partnership. On the whole, the charter provisions relative to capital stock are simple, and it may be added that simplicity is desirable. Where many classes of stock are issued the tendency is toward the development of group interests among the stockholders which may reflect unfavorably upon any concerted action on the part of all interested in the business.

5. Incorporators. — In all of the states it is required that the charter give the names and places of residence of each of the original subscribers to the capital stock, and the number of shares subscribed for by each. Where one of the conditions prerequisite to the granting of the charter is that a certain per cent of the capital stock shall be subscribed to and paid in, this section is important.

6. Duration. — This section simply states the period for which the charter is granted, either for a period of years or in perpetuity.

7. Liability. — Although not required, a statement of the liability that the stockholders assume is frequently inserted, especially in charters granted by states that impose double liability.

8. Directors. — There is always a section of the charter devoted to the directors. In its briefest form, this simply sets forth the number of directors and their qualifications. These qualifications vary greatly, but it is quite common to require that at least one director shall be a resident of the state of incorporation, and that a person to be eligible to hold the position of director must be the holder of at least one share of stock.

As the authority of the board of directors under the common law extends to all subjects connected with the management of the corporate affairs, any restrictions upon this wide power should be provided for by inserting them either in the charter or in the by-laws. The more important ones are commonly found in the charter, for example, provisions limiting the power of directors to sell or mortgage the property of the corporation, to incur indebtedness, to pass by-laws, etc.

Classification of directors so that their terms of office do not all expire at the same time is desirable and is usually provided for in the charter. Its aim is to secure a stability of management.

If the board of directors is large, it may be found advisable to provide for standing committees composed of members of the board. They may be provided for in the charter or in the by-laws. Two such committees are usually found, an executive committee and a finance committee, the former exercising general powers of direction and the latter acting on matters pertaining to finance.

9. Special Provisions.—The general corporation laws of the states up to 1896 were not very liberal in the powers granted under them. They sought, as it were, to cast all corporations in the same mold, which of itself was sufficient to prevent broad freedom of action and flexibility in structure of the corporate organization. The first marked change in this policy came with the passage of the New Jersey act of that year. To this act was added, two years later, the following clause: "The certificate of incorporation may also contain any provision which the incorporators may choose to insert, for the regulation of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders, or any class or classes of stockholders;

provided such provision be not inconsistent with this act." Other states soon followed suit, notably, Delaware, Maine, West Virginia and to a less extent New York.⁵

Such provisions as the above, and others, make it possible to insert clauses into the charter vesting the corporation with special powers and providing for special features which otherwise would have to be taken care of as well as possible in the by-laws.

Among the objects that are usual subjects for special provision clauses are the classification of directors, the limitation of directors' power to incur debts or to sell the assets of the corporation, cumulative or other methods of voting, limitations on salaries of officers, sub-classification of stock, and power to own the stock and securities of other corporations.

BY-LAWS

The underlying statutes and the charter of the corporation are usually supplemented by an additional set of rules and regulations called *by-laws*. These not only determine to a considerable extent the details of the form of organization that the corporation is to employ, but also serve at the same time as a guide setting forth the rules of procedure that are to govern the stockholders, directors and officers in carrying out the various functions of the corporation. In a small corporation whose stockholders are few in number and for the most part serve on the board of directors, there is little need of a set of by-laws; but in the case of a large corporation whose stockholders may run into the thousands, and whose board of directors may consist of well over a score of members, a set of by-laws drawn up with great care and foresight, even with respect to fine points of detail, is almost indispensable. Practically

⁵ T. Conyngton, *Corporate Organization and Management*, pp. 172, 173.

all of the larger corporations have very complete by-laws.

Purpose and Adoption.—The by-laws, in most cases, emanate from the stockholders. It is only by laying down a more or less rigid set of rules and regulations governing the qualifications and functions of the directors and officers that the stockholders may retain a semblance of control over the functioning of the impersonal organization that they have interposed between themselves and their business property. Here, then, we find the chief purpose of the by-laws, namely, to protect the stockholders of the corporation as far as possible against the unlawful or unauthorized acts of its directors, officers and agents.

In the great majority of the states the power to adopt by-laws is reserved to the stockholders, who may ordinarily adopt or amend them at any regular meeting in accordance with the statutes, the charter and such rules as may have been previously adopted. A few exceptions to this general rule can, however, be noted: in Illinois the statutes give the directors the power to make and amend by-laws to the exclusion of the stockholders;⁶ under corporation laws modeled after the laws of New Jersey the charter may be so worded as to give the directors power to adopt by-laws, and in New York the statutes give the directors power to adopt by-laws not inconsistent with those passed by the stockholders. Taken by-and-large these exceptions seem to be diametrically opposed to the theory of impersonal organization for business purposes. This leaves the advisability of such a practice open to serious doubt; the more so, in view of the extremely lax qualifications for directors.

The by-laws, when used, are usually prepared in advance of the first meeting of stockholders by the incorporators or their attorney, and are read and adopted by a majority (or a two-thirds) vote of the outstanding stock.

⁶ Conyngton, *Corporate Organization and Management*, p. 192.

Once adopted they may be amended at any regular meeting.

Contents. — The content of corporate by-laws, in so far as the general subject matter is concerned, has become fairly well stereotyped and standardized. Complete sets, ready for use, can be furnished at a moment's notice by any reputable attorney who specializes in corporate organization. The topics ordinarily treated may be classified as follows:

1. Stockholders
2. Directors
3. Standing Committees (if any)
4. Officers
5. Stock
6. Dividends and Finance
7. Sundry Provisions
8. Amendments

Under each of the above titles are usually included in brief and succinct form the more salient provisions of the statutes of the state of incorporation, the provisions of the charter and such other additional regulations pertinent to the subject as may be deemed necessary.

The discussion and explanation of the several subjects treated in the by-laws, and enumerated above, are so closely connected with a description of the functioning of the corporation that it is thought best to leave them for the next chapter.⁷

⁷ A full reprint of the By-Laws of the United States Steel Corporation is given in Part VI, Form 31.

CHAPTER X

THE CORPORATION—ITS OPERATING MECHANISM

THE principle underlying the operating mechanism of the corporation is characteristic of the securities-issuing organization. It consists of the separation of the three functions of ownership, direction and management, and their delegation to three legally distinct bodies respectively, the stockholders, the board of directors and the officers.¹ The duties, obligations, right and privileges of each body are generally clearly defined by statutory law and by sections in the charter or by-laws of the corporation.

The corporation cannot well dispense with any one of these three bodies. Though at times their personnel is identical, as in the case of a small *close* corporation whose stockholders are so few that all are at the same time on the board of directors and serve also as officers. In such cases, confusion frequently results through laxness in observing the provisions of the law or of the charter delegating to each body its distinct duties and powers. Thus the persons interested in the corporation often fail to keep proper records, or do not distinguish clearly whether action was taken by the stockholders, by the directors or by the officers. Such actions as these are irregular and might lead the corporation into difficulties. Large corpora-

¹ This is the American practice. In England, the checking up on operation is done by independent auditors; while in Germany, a supervising board is prescribed in addition to the board of directors, stockholders and officers, and independent auditing also is provided for.

tions take great care to follow the letter of the law in all these matters, and invariably employ an attorney to give them the necessary legal advice.

THE STOCKHOLDERS

The body of stockholders of the corporation constitutes the entrepreneurial element in the organization. It consists of all persons, natural and artificial, who are the rightful owners of at least one share of the corporation's stock. There is no restriction as to who may become a stockholder, except in those states that prohibit one corporation from holding the stock of another.² The ease of transferring shares, coupled with the relatively wide range of potential stockholders, results in a continual change in the personnel of the body of stockholders, particularly in the case of the larger corporations. This condition is well illustrated by reference to the table showing the percentage of turnover of stock of some large American corporations. Each sale of stock effects a change in the personnel of the body of stockholders. The reports of the United States Steel Corporation, giving the number of common stockholders receiving dividends each quarter year, are also illustrative of this point.

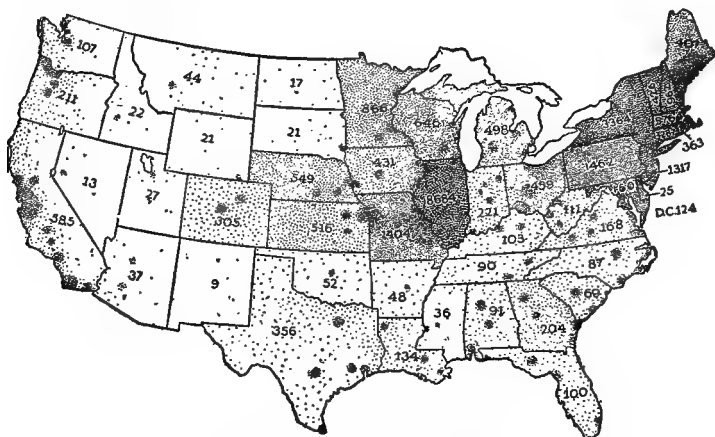
The following table shows the number of common stockholders of the United States Steel Corporation for each quarter from 1915 to 1920:

Year	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
1920		90,952	87,229	83,583
1919	73,318	73,456	74,071	78,018
1918	72,779	65,862	63,507	61,044
1917	51,689	44,789	43,482	42,564
1916	37,720	40,430	41,156	41,910
1915	45,767	51,169	55,907	56,825

² This was, with certain exceptions, the law in New Jersey from 1913 to 1920.

The fluctuation is very largely the result of market conditions. It tends to increase as the dividends and quotations of market prices rise, and vice-versa. In small corporations, where the stock is generally closely held, these fluctuations are not common, unless the enterprise is of a highly speculative character, as in oil and mining development undertakings. A glance at the accompanying chart shows us how widely the stockholders of large corporations are distributed over the country.

Distribution of Stockholders of Swift & Company:



(Courtesy of Swift & Company)

As entrepreneurs of the business, the stockholders naturally assume the major portion of the risk of loss; and, in consequence, they enjoy also the right to any profits that the business may produce. Theoretically, they exercise the same function in connection with the operation of the corporation as do the enfranchised citizens in the operation of the state or municipality. But they are no more the corporation itself than are the citizens the state. They are the final arbiters of its destiny, the beneficiaries of its successes and the victims of its failure.

Powers of Stockholders as a Body. — The rights of the

individual stockholder should be carefully distinguished from the powers of the stockholders as a body. The rights referred to have already been discussed in a preceding chapter. The stockholders can act as a body only when properly brought together in regular and special meetings. Their powers on behalf of the corporation, when they are thus assembled, are, in most states, clearly defined by statutes and are usually also restated in the by-laws of the corporation. Among these powers, those that stand out most prominently are the following:

1. To adopt a seal
2. To elect directors and to remove them for cause
3. To adopt and to amend by-laws
4. To authorize the issuance of stock
5. To amend the charter (effective only when sanctioned by the state)
6. To dissolve the corporation (also requires state sanction)
7. To sell or mortgage the entire assets of the corporation

Classification and Qualification. — Whenever a corporation issues more than one class of stock, its stockholders are thereby divided into as many classes as there are kinds of stock. The special rights, privileges and powers that the holder of any class of stock enjoys, are clearly defined in the stock certificate or in the charter or by-laws. This is necessary because of the general rule that holders of preferred stock are held to have all the same rights, privileges and powers as common stockholders with such additions and limitations as are specifically granted in the creating clause of the charter or by-laws. This rule holds whether they are considered as individuals or as a body. In large corporations it is quite generally the custom to provide for at least two, and frequently three or more, classes of stock and hence for as many classes of stockholders. This practice has at times been ill-advisedly

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adopted with serious consequences to the corporation and especially to the common stockholders, as in the case of the United States Leather Company.³ What advantage stock classification may offer in matters of finance is frequently discounted by the fact that it tends to make the interests of the various classes of stockholders opposed to one another, and thus destroys the solidarity of the body.

Stockholders of Record.—While it is, broadly speaking, correct to say that anyone who owns a share of stock in a corporation is a stockholder in it, it is, nevertheless, incorrect to assume that he thereby becomes privileged to participate in the deliberations of the body of stockholders. Something more than mere ownership of stock is required for this. He must be not only a stockholder, but also a stockholder of record; this means that his name, together with the amount of stock and the numbers of the certificates that he holds, must appear on the official stock ledger and transfer books of the corporation. These books are in the hands of the secretary, who is required to note therein all issues and transfers of stock, so that he may know who is entitled to participate in stockholders' meetings and dividends; and it is to the stockholders of record only that the secretary sends out notices of meetings and the declaration of dividends. These books are usually closed a fixed number of days before the stockholders' annual meeting is to take place or dividends are to be declared, in order that no question may arise as to who is entitled to participate. The date of closing the books is fixed by the by-laws.

Transfer Agent and Registrar.—The work of maintaining an accurate record of all transfers of stock, especially in large corporations, may become quite onerous. In such cases, a transfer agent and a registrar are found to be

³ See Dewing, *Corporate Promotions and Reorganizations*, pp. 16-49.

almost indispensable — the transfer agent to keep a record of transfers and the registrar to certify to the correctness of the roll. The authority to employ these agents is given in the by-laws, which frequently even designate some trust company to perform both services. In this way a certified list of stockholders can always be secured when desired.

Stockholders' Meetings. — The body of stockholders has one regular meeting yearly, called the *annual meeting*; and in addition thereto such other *special meetings* as may be found necessary. The annual meeting is ordinarily the most important function for the stockholders. It is at this meeting that they elect directors for the ensuing year, amend or adopt new by-laws and consider and act upon any matters whatever, concerning the corporation, that come within their scope of action and are properly brought before them. The date for holding the meeting is fixed by the by-laws, and is, therefore, generally known to the stockholders. But to make sure that all stockholders of record are notified the by-laws usually provide that the secretary shall, upon a definite date before the meeting is to take place, close the books and send out a general *call and notice*⁴ to all stockholders of record. The rules of procedure that are to govern the meeting are usually inserted in the by-laws, but need not be rigidly adhered to. They commonly prescribe who shall be the presiding officers, in what order business shall be conducted, what shall constitute a quorum and what method of voting shall be used.

Officers. — Usually the president and the secretary of the corporation act as presiding officer and recording secretary of all stockholders' meetings, though this practice is not universal. Infrequently the body of stockholders chooses its own officers at each meeting.

Quorum. — In many of the states the proportion of the

⁴ See Forms

outstanding stock that must be represented at a stockholders' meeting to constitute a quorum, is fixed by law. Where this is not done, the common law rule holds that those present, regardless of the amount of stock they represent, constitute a quorum to transact business or elect directors. The question, however, generally is considered to be of sufficient importance to merit a by-law provision, in which the quorum for the transaction of business is commonly fixed at a majority of the outstanding stock, while for the election of directors those present, regardless of numbers or the amount of stock represented, are held to be sufficient. This arrangement is in widespread use among corporations chartered under the laws of the state of New York. Such matters as the amendment of the charter, the sale of the entire assets and the dissolution of the corporation under many state laws require at least a two-thirds majority of all outstanding stock. They thus require a quorum equally large.

Method of Voting. — Several different methods of voting at stockholders' meetings are in use. Among these, the ones most commonly found in this country are the straight ballot and the cumulative method. In addition to these two plans, there is in use in England a third which is best described as a regressive plan.

The *straight ballot* plan provides for the casting by the stockholder of one vote for each share of stock in his possession upon each motion placed before the body of stockholders at any meeting. In electing directors each vacancy is filled separately. A bare majority under this plan is sufficient to elect a director, to amend the by-laws or to carry a motion relating to the transaction of ordinary business. Thus anyone who can secure control over more than fifty per cent of the outstanding stock, is in a position to impose his will upon the minority stockholders in these matters. For the election of directors, where the stock

represented constitutes a quorum, twenty to thirty per cent, and even less, is frequently sufficient to elect. But the majority can usually retain control and easily regain it if it happens to be lost. This system may, thus, exclude the minority stockholders from any representation on the board of directors, and therein lies its greatest weakness.

The *cumulative* plan of voting is now quite general, though its use is confined to the election of directors. In some states the statutes provide that it shall be used in such elections; in Colorado, it must be employed unless some other plan is provided for in the charter, and in nearly all of the states it is permissible. Under this plan the stockholder is entitled to cast one vote for each share of stock that he holds for each director to be elected. These votes need not be cast separately for each place to be filled, but may be cast together for a single candidate. This enables an organized minority to concentrate its votes upon one or two candidates agreed upon, with a reasonable assurance that it can elect them, thus securing minority representation on the board of directors. A large well organized minority can even wrest the control of the board from a poorly organized, scattered majority by properly distributing its votes. For example: Three directors are to be elected. The minority stockholders, controlling 45 per cent of the total number of votes, agree to concentrate upon two candidates, A and B; while the majority, controlling 55 per cent, try to fill all three places with C, D and E. The percentage of votes received by the candidates is as follows:

	A	B	C	D	E
Minority	23	22	—	—	—
Majority	—	—	25	14	16

Thus, the majority stockholders will have filled but one place out of the three by scattering their votes too much.

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Had they been content with two places, they could easily have secured them.

The English *regressive* or differential plan is based on a relative diminution of voting power with a progressive increase in shares held. Thus, a person holding 50 shares, or less, of stock, has one vote for each share. If he holds more than 50 and less than 100 shares, he has one vote for each of 50 shares and one vote for every 2 shares above that number. For all shares above 100 and under 150 in number he has one vote for every 3 shares, and so on. The purpose of this plan is to give greater power to the minority, which ordinarily consists of stockholders whose individual holdings are small. The complexity of the plan militates against its use; and though permissible, its use in this country is very rare.

Voting by Proxy. — It is the common law rule that the stockholder must attend meetings in person to exercise his voting right. In some of the states there are statutes that permit him to delegate this right to another person when he cannot, or does not himself desire to attend. Where no such statutes exist, a charter and by-law provision will usually have the same effect. The instrument by means of which the voting right is delegated to another is a power of attorney, called a *proxy*. The proxy must authorize a specified person to represent the stockholder at one or more meetings. It may authorize him to vote upon all, or only upon certain specified matters; and it may permit him to exercise his own judgment in voting or prescribe how the votes are to be cast. Under many statutes, the length of life of the proxy is limited by a provision requiring that it be executed within a certain number of months preceding the date of the meeting. Under the federal law a small tax must be paid on all proxies. It is customary to refer to the person to whom the voting power is delegated as "the proxy." Any person who is competent at law to act as agent may act as proxy.

Stockholders' Voting Trusts. — The principle of placing property in the hands of a trustee, to be managed by him for the benefit of the original holder, is well recognized at law. The stockholders of a corporation frequently avail themselves of the trust agreement to conserve certain special interests, to retain control of the corporation in the hands of the majority or more effectively to protect the interests of the minority or some class for a consecutive term of years. These trusts are formed by vesting the title to the stock in one or more trustees, who thereupon issue to the stockholders entering the trust, trustees' certificates representing the number of shares deposited. The trustees thus become possessed of all the rights of stockholders including the right to vote and to receive dividends, and their names appear on the stock transfer books as the rightful owners of the shares of stock deposited with them. They must vote, dispose of dividends and otherwise act as stockholders of the corporation in strict accord with the terms of the trust agreement entered into between themselves and the participating stockholders. While the agreement is in force, the trustees must keep the securities intact, cast the votes en-bloc and otherwise treat the trust property as a unit until such time as the trust agreement expires, or the trust is dissolved by mutual consent or as provided for in the agreement. Such voting trusts are also frequently known as "stock pools."

Voting trusts are expressly sanctioned by the laws of the states of New York and Maryland, and have been declared lawful in many other states. It is the opinion of an eminent corporation lawyer "that a voting trust, reasonable as to its duration and equitable as to its purpose, would be sustained in any state of the Union."⁵ When the voting trust is employed to bring two or more corpora-

⁵ Thomas Conyngton, *Corporate Organization and Management*, p. 449.

tions under the close control and supervision of a small group of trustees, it becomes a combination trust. This type, as in the case of the old Standard Oil Trust, quite generally has been declared illegal on the ground that such a trust divests the stockholders and directors of the corporations of their control over them.

Protection of Minority Stockholders. — From what has been said relative to the body of stockholders, it is apparent that the minority stockholders have little or no influence in determining the basic policies upon which the operation of the corporation must rest. This fact is at the same time one of the weakest and strongest features of the corporate form of organization. The great advantage of the majority rule plan lies in the decisiveness and continuity with which an action, once decided upon, may be carried through. The minority stockholder has, ordinarily, only one of two alternatives to follow: He may either accept the majority's decision, or sever his connection with the enterprise by disposing of his stock.

After the corporation has once been formed and put into operation, there is little chance that any special minority interest will be safeguarded or protected. If it is at all desirable to protect special minority interests — as frequently is the case in transforming a partnership where the interests of the several partners vary and must be preserved in the corporate form — this should be done when the charter is prepared. At that stage of incorporation proceedings, it is possible in several ways to conserve special rights and privileges of the several partners, particularly in the matter of preserving an equal voice in the management in the face of unequal capital investments and special limitations on the capital risk. Among the special organization features that are most frequently employed for this purpose are the following:

1. Special kinds of preferred stock
2. Classification of common stock into voting and non-voting classes, or into blocks each of which is given power to elect a specified number of directors
3. Cumulative voting
4. Special majorities to authorize certain acts such as the sale or hypothecation of the assets, etc.

It is obvious that the majority stockholders have the power to control the policies of their corporation. Such an arrangement is unquestionably just and right. To be sure, they cannot exercise this power for the purpose of discriminating against the minority, but must exercise it to foster what in their opinion is to the best interest of the corporation. If they do otherwise, they may be brought before the courts for violation of law. Any protracted struggle between the majority and minority interests of a corporation will result only in impairing its chance of success and may ultimately result in its ruin. The minority stockholders, in such cases, are not obliged to retain their shares. If they are dissatisfied with the majority policy they had better sell their stock rather than to launch a campaign of obstruction and hindrance. If, therefore, special rights and privileges attached to the person of the entrepreneur are to be preserved, this is much more satisfactorily accomplished through the use of special types of personal ownership organization than through the corporation, whose highly impersonal character makes it less adaptable to such a purpose.

THE BOARD OF DIRECTORS

The Function of the Board of Directors. — It is through the exercise of authority and power vested in the board of directors that the business corporation becomes a live entrepreneurial organization. Without a board of directors

the business corporation cannot function. The function of the board, then, is to manage the corporation and to direct its operations within the scope of the broad lines of policy laid down by the stockholders. This function of management, coupled with custodianship of the property of the corporation, places the members of the board, collectively and individually, in the position of trustees of the corporation; and as such, they may have no interests adverse to those of their company.

Election, Term of Office, Etc.—The members of the board of directors are elected by the stockholders at the annual meeting of the latter body. The procedure to be followed in such elections has already been described in the preceding section of this chapter and need not be restated here.

The term of office of directors is ordinarily one year; but the incumbent continues to serve and to perform the duties of the office until a successor is elected and qualifies. Thus, if for any reason the stockholders neglect to hold an annual meeting or pass over the election of directors, the whole existing board would continue to serve. In small corporations whose stock is closely held by but a few stockholders it is quite common in this way to permit a board of directors to continue in office for several years without change. This practically makes the board a self-perpetuating body, for any vacancies that occur between stockholders' meetings may be filled by the remaining members of the board.

Classification of directors is often resorted to in order to minimize the probability of sudden changes in managerial policy. Such classifications usually provide for a three year term for directors, and divide the body into three sections so that the terms of the members of one section will expire each consecutive year. This practice, however, is confined very largely to those corporations that have a relatively large board. Where the board is small it would

serve no purpose. For such a classification see the charter of the United States Steel Corporation in Part VI.

If for any reason, the stockholders desire to remove a duly elected and qualified director, they have that power within certain limitations. Under common law rules they can remove him for good cause only and must give him an opportunity to be heard and to defend himself at the stockholders' meeting. The common-law rule is modified in many states by statutes permitting the removal of directors more or less at will by a majority vote of the stockholders at regular or special meetings called especially for that purpose. The same freedom in the removal of directors may also be secured through charter or by-law provisions; and such provisions are very frequently found.

Number and Qualifications of Directors. — The statutes of most states prescribe a minimum number of directors, three and five being the more common. A few state laws establish also a maximum number, as in Colorado. In practice there is a wide range extending from three to thirty and even more. Whenever possible an odd number is chosen, because this will prevent a tie vote. Tie votes in the board of directors are not only annoying but also detrimental to the best interests of the corporation. A board that, due to its organization, cannot agree upon a decisive action is useless to the corporation. However, in corporations that have been formed from partnerships it is frequently desirable to have an even number of directors in order to preserve an equal share in the management of the reorganized business; but this is possible only in those states whose laws do not prescribe an odd number.

The qualifications for the office of director of a corporation are few. At common law any natural person who has attained his full legal rights may be elected to the board. In nearly all of the states, the statutes now modify this rule by requiring a director to be the owner of at least

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one share of the corporation's stock. This requirement is little more than a legal formality. Any hireling who may legally enter into a contract may be presented with a single share of stock to qualify him for a place on the board of directors, be elected to that place and then be required to vote as directed or ordered by the interests that placed him there, and be paid for his services in the bargain. Such a director is called a *dummy director*. Dummy directors are frequently employed to round out the required number of directors in corporations formed from partnerships, and also where state laws require that at least one director be a resident of the state of incorporation. The stock ownership qualification is of such small moment that it might as well be done away with. Rhode Island, in its recently adopted corporation laws omitted it entirely. In Massachusetts, in 1919, it was modified so that a manufacturing corporation may, through by-law provision, arrange for the nomination and election by its employees or one or more of their number to membership on the board of directors.⁶

Residence within the state of incorporation for at least one director is also a common requirement which is easily complied with through the use of a dummy. The demand for dummies for this purpose has become so great in such states as Delaware and New Jersey that a corporation has been formed whose purpose it is to supply them to outside corporations incorporated under the laws of these states. It has happened that dummies of this type have had the deciding voice on the board in case of a tie vote of contending factions.

In addition to these general qualifications, a number of the states require that at least one, and sometimes more, of the directors must be citizens of the United States. In

⁶ New Jersey corporations were authorized to do the same thing in 1920.

the absence of such a provision an alien may qualify under the common law.

Compensation. — The directors of a corporation may receive compensation as provided for in the statutes, the charter or the by-laws. Regular salaries, while not generally prohibited, are uncommon. The usual practice is to pay directors a nominal sum for each meeting; these sums range from five to twenty-five dollars; in most small corporations, however, directors serve without compensation.

The Individual Director's Relation to the Corporation. — In the external relations of the corporation, the individual director plays no rôle. He has no greater power to bind the corporation in contracts than the individual stockholder. Any attempt on his part to enter into a contract on behalf of the corporation without special delegation of authority by the board of directors would be, as far as he is concerned, an act *ultra vires*, or beyond his powers, which would make him individually liable.

In connection with the internal relations of the corporation the individual director possesses certain rights and privileges not enjoyed by the individual stockholder. However, even these are restricted to such rights and privileges as are of themselves necessary to enable the director to familiarize himself with the corporation's affairs, so that he may act intelligently on its behalf. Thus, he has the right to inspect all of the books, records and accounts of the corporation as well as its property, and also to be notified of, and to participate in, all directors' meetings and meetings of standing committees. The right of the director to inspect books, records, etc., is much broader and more comprehensive than that of the stockholder, for he must know the condition of the physical as well as the financial affairs of the corporation if he is to be responsible for its management.

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It is at once seen that the individual director, as such, possesses no special rights and privileges that give him any direct power or authority to manage the affairs of the corporation. This must be done through the board of directors acting as a body.

Powers of the Board of Directors.—As before stated, the function of the board of directors is to manage the corporation. To enable the board to perform this function properly, it is vested with wide powers. In fact, in the board of directors are embodied all of the powers that the corporation enjoys by virtue of having been created an artificial person; and the board exercises them to the exclusion of the body of stockholders and officers. These powers may be summarized as follows:

1. To take such measures consistent with law, as the directors may deem advisable for the proper management of the corporation
2. To delegate the exercise of managerial authority to others
3. To adopt a stock certificate and to issue stock
4. To declare dividends
5. To fill vacancies on the board
6. To exercise certain miscellaneous and special powers by virtue of by-law provisions.

Power to Manage.—In the exercise of its managerial power, the board of directors is authorized to plan and build up the administrative and operating force of the corporation; to select the sites and location of its establishments; to erect, operate and maintain the physical plant and equipment; to enter into all contracts on behalf of the corporation; and to determine and carry out its financial policy.

It is, of course, incumbent upon the directors to exercise such discretion and caution in these matters as might be taken by any prudent business man. They cannot wilfully and knowingly waste the corporation's assets or

employ them for their own private gain without incurring a personal liability toward the creditors and the stockholders. But, with the exception just noted, the limitations upon the free exercise of managerial powers through statutes are few and unimportant. If it is deemed advisable or necessary to limit it in any way, this is usually done through charter and by-law provisions. Among limitations of this sort are commonly found such as require an extra majority of the board to incur expenditures above a certain specified amount; that prescribe maximum limits for salaries of officers, directors and agents, or that limit the indebtedness that the directors shall be permitted to incur.

Delegation of Authority. — Under the common law the directors are obliged to attend in person to managerial matters; they cannot delegate this authority to others. This rule may be changed by statute, charter provisions or by-laws. The ordinary practice now is to permit the directors to delegate the exercise of their managerial authority, either in whole or in part, to a select group of their number or to agents; though in so doing they do not relieve themselves of responsibility for the acts of such agents. To relinquish responsibility they would have to resign from the board.

The powers of the board may be delegated to a single director to be exercised by him within such bounds of discretion as the board may determine. This would make him a *managing director*. Except during directors' meetings he becomes the supreme manager of the business, having control over the entire operation of the business including authority over the officers. The managing director is most commonly found in small corporations where one man is familiar with the details of technique and operation while the others are merely contributors of funds.

In large corporations the board of directors frequently

has from twenty-five to thirty or more members. They are usually busy men whose interests are so varied that they can devote little time to board meetings. Consequently it is at times difficult to secure a quorum. It is also quite certain that some members of the board will be experts in finance while others have exceptional executive ability and still others may have little knowledge of the problems connected with the business. In such cases, it is found desirable to delegate authority over executive matters and finance to special committees made up of a small number of especially qualified men chosen by the board from among its members. In this way are constituted the *executive committee* and the *finance committee* of the board of directors. These committees cannot, however, delegate any authority vested in them to others but are directly responsible to the board for their actions. Any member of the board has full right to sit in at any of their meetings. The number of directors that is to compose the committees, the procedure in appointing them and the powers given them are usually carefully set forth in the by-laws of the corporation.⁷

The ordinary duties of supervision of the operation and administration of the corporation, while they are by law vested in the board of directors, are by that body usually delegated to officers chosen for that purpose. The duties, powers and obligations of these officers will be reserved for discussion in the last part of this chapter.

Power to Fill Vacancies.—Whenever any vacancy occurs on the board of directors such vacancy may be filled by the remaining members of the board for the unexpired term. A majority vote of the full board is ordinarily required for this purpose, but through by-law provision an extra majority may be required with a view to protecting the minority interests.

⁷ This is well illustrated by the by-laws of the United States Steel Corporation given in Part VI.

Power to Declare Dividends. — The power to declare dividends rests exclusively with the board of directors. This is perhaps their most important power. It is by the size and regularity of the dividend that their success as managers is measured; and the failure, on their part, to follow carefully provisions of law governing the declaration of dividends may make them both civilly and criminally liable for their acts.

Statutory restrictions upon the declaration of dividends are few and clear, but strict. The cardinal principle which they lay down is that dividends must be declared out of surplus or net profits. They cannot be declared out of capital except in undertakings that are of a wasting nature as mining, quarrying, oil production and the exploitation of patents, where the purpose of the business is to exhaust the marketable value. If for any reason, including losses and depreciation, the capital of the corporation has fallen below what was originally received by it as representing the fair value of the stock issued, the earnings must be applied toward rounding out its capital and cannot be distributed as dividends. This general rule has been adopted by most states to protect not only the creditors of the corporation, but its stockholders as well. However, a distinction is made between what constitutes the capital account and the expense account of the corporation; and it is the general rule of the courts to hold that this is a matter for business men to determine. Directors frequently take advantage of this in order to declare dividends as often as possible at the risk of impairing the future earning power of their corporation.

The by-laws of the corporation usually restate very briefly the statutory provisions of the state of incorporation relative to the declaration of dividends, and in many cases prescribe the procedure that is to be followed by the directors when dividends are to be declared. An example

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of the latter type is found in the by-laws of the United States Steel Corporation given in Part VI.

The procedure that is followed in the larger corporations in declaring dividends, is about as follows: First, a statement is secured from the treasurer to ascertain whether the net earnings are sufficient to declare a dividend. Second, in case the net earnings are sufficient the dividend is declared by a formal resolution of the directors. This resolution usually sets forth that the directors of the corporation have declared a dividend of a specified per cent of the par value of the stock, to be paid on a specified date to stockholders of record, as of a date five to ten days in advance of the date of payment. Sometimes the dividend is stated as so many dollars per share as would be necessary with non-par value stock or for any other reason. Third, notice is thereupon given the stockholders, and is usually also published in the newspapers, although the latter act is not required. Fourth, the secretary of the corporation closes the stock transfer books, which then furnish the treasurer with a list of stockholders who are to receive the dividend. Fifth, the treasurer pays the dividend on the specified date, usually by check so marked as to indicate that it is a dividend, and in this way receives the check as a receipt from the stockholder when it has been endorsed by him.

Kinds of Dividends.—The ordinary dividend is paid in money and is called a *cash dividend*. Dividends may, however, be paid in some form other than money; as for example, in the form of stock of the corporation, bonds issued by it, its scrip or its property.

If the dividend is in the corporation's stock, it is called a *stock dividend*. The mere distribution of unissued or treasury stock pro rata among the stockholders, does not constitute a stock dividend, but merely watered stock. The amount of stock to be issued through a stock dividend is

determined by the net earnings available for distribution as dividends. Instead of giving to each stockholder a cash dividend, the corporation retains the net earnings as a sort of additional investment pro-rated among the stockholders, and distributes from its unissued stock a sufficient number of shares at par to equal the total of the declared dividend. The corporation thereby increases its outstanding securities by the amount of the stock dividend. Under a decision of the United States Supreme Court, handed down in March 1920, stock dividends are not income taxable under the Federal Income Tax. As a result of this decision there were issued by some 129 corporations and companies, between March 1920 and January 1, 1921, stock dividends aggregating \$777,875,932. Some of these concerns in this way increased their capitalization four-fold. Such a procedure may have the effect of unduly reducing the working capital by transferring surplus to invested capital and some of our corporations, particularly one large rubber company, have been severely criticised on this score.

Bond dividends paid to the stockholders in the form of the corporation's own bonds would have the same effect as a forced, long-time loan, because the dividends, when once declared, make the stockholders creditors of the corporation to the amount of the dividend. If the corporation then gives them its bonds, they remain creditors until the principal is paid. This practice is not very frequently resorted to.

Scrip dividends have the same effect as bond dividends; namely, they make creditors out of the stockholders. The scrip given the stockholder is merely a non-interest bearing promise to pay. It has usually but a short tenor and is made payable in cash.

Property dividends have the same effect as though the assets of the corporation were distributed in whole or in

part. They are possible only where the property is divisible into units or parcels, as land or the owned securities of other corporations. Many corporations, which, during the recent war made heavy purchases of government bonds, have distributed them among their stockholders in the form of property dividends.

Illegal Dividends.—Whatever form the dividend may take, it must be equal for every share of stock of a given class and must be distributed to the several classes in the order of their claims to priority. Failure on the part of the directors to observe this principle, or to guard against impairing the capital of the corporation or to conform to charter and by-law provisions in the declaration of dividends makes the dividend illegal. Any stockholder may enjoin them from paying such a dividend and may hold them personally liable for their acts. But dissenting directors may protect themselves by having their dissenting votes recorded on the minutes of the directors' meeting.

Other Powers of Directors.—The board of directors is frequently empowered to mortgage the property of the corporation. When granted, this power is usually limited by requiring a two-thirds or three-fourths majority vote of the entire board as well as by fixing the maximum amount of indebtedness that may be incurred.

In a few states, such as New York and Illinois, the directors may also be given power to adopt by-laws governing their own actions.

Meetings of the Board.—Ordinarily the by-laws of the larger corporations provide that the board of directors shall have one regular meeting monthly and such special meetings as may be deemed necessary. The procedure in these meetings is similar to that followed in stockholders' meetings. Usually the president of the corporation presides, and the secretary acts as secretary of the board meeting, but this practice is not universal. In the New York Cen-

tral and Hudson River Railroad Company there is a special presiding officer called the chairman of the board of directors. The standing committees may be called upon by their chairmen to meet much more frequently than the entire board and their procedure is usually somewhat less formal.

THE CORPORATE OFFICERS

The function of the officers of the corporation is primarily that of administration. They constitute the binding link between the entrepreneurial and the administrative organizations, thus making a live business unit out of the artificial person of the corporation. They are at one and the same time the agents of the board of directors and of the corporation. Unless otherwise stipulated in the statutes, charter or by-laws, they are directly responsible to the directors for all official acts and are absolutely controlled by the board.

As the work of corporate administration may be readily subdivided into such functions as (a) executive direction, (b) custodianship, (c) secretarial services, (d) check on performance and (e) legal services, the officers are usually selected with a view to meeting the requirements of the corporation in these matters. In practically all corporations there is need of permanent officers to perform the first three of these functions. The necessity for the exercise of the others may arise only occasionally. Hence, permanent officers are not always employed to look after that work, temporary assistants being employed by the board of directors as the occasion demands.

The statutes of the states are generally silent concerning the officers of the corporation other than directors, who are frequently called officers. Even the charter seldom contains clauses bearing on them. For this reason the by-laws should—and as a rule do—go into considerable detail concerning officers. They usually stipulate the names by which

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the officers shall be known, by whom they shall be chosen or appointed, what qualifications, if any, they shall possess, the length of their term of office and the functions and duties that are assigned to them. Any rules or regulations upon these points may ordinarily be adopted by the stockholders or may even be left to the discretion of the directors. The prevailing elasticity and freedom of action in the adjustment of these matters, has resulted in the adaptation of the staff of officers to the size of the corporation as well as to the nature of the business in which it is engaged.

As a rule the directors appoint, or elect, the officers of the corporation and also control them during their incumbency. Unless otherwise provided in the by-laws, they need not be stockholders; but where they are to serve on the standing committees of the board of directors, they must, of course, qualify as directors. Their term of office is usually co-terminous with that of the directors or for a period of one year. Provision is also made for their removal at the will of the appointing body, in order that they may be more easily controlled and their actions brought into harmony with the policies of the board of directors.

General Executive Officers.—Ordinarily the *president* of the corporation is its chief executive officer entrusted with the supervision and direction of its operations. He is usually made directly responsible for this work to the board of directors, but in some corporations he is subordinate to a managing director, in which case, much of the power and authority ordinarily vested in him may be exercised by his superior. In addition to these duties he may also be the presiding officer at stockholders' and directors' meetings and chairman of the executive committee of the board. One of the most important duties is to prepare annual reports on the corporation's affairs for the directors and the stockholders.

Where the corporation is large, it is frequently found to be advisable to supply the president with one or more *vice-presidents* who may serve as his immediate administrative subordinates. These may be officially designated as "first," "second" or "third" vice-president according to their number. In some corporations the office of vice-president is merely an honorary position whose incumbent has little to do with the general administration, while in others the vice-presidents are the active and responsible heads of the administrative departments immediately subordinate to the president in whom the general supervisory and coordinating power is vested.

When the position of vice-president is honorary it is customary to appoint a *general manager* and to make him directly responsible to the president for the operation of the business. Where the board of directors appoints both the general manager and the president—an arrangement that is found in a few corporations—the status of the president assumes more the character of a nominal as against an actual executive head.

Treasurer.—The *treasurer* is the custodian of the corporate funds, securities and valuable financial documents. It is also his duty to keep the corporation's books of account, to serve as its responsible agent in the disbursement of funds, and to prepare reports concerning the finances of the corporation for the information of the board of directors and the stockholders; and he is frequently also required to participate in the execution of instruments of a financial character such as notes, bonds, etc., issued by the corporation. The importance of his position shows great variation. In some corporations he is little more than the head of the bookkeeping and accounting department, while in others he is made chairman of the finance committee and is looked upon as the financial advisor of the corporation.

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It is obvious that the nature of these duties, which are usually definitely assigned to him by the by-laws, place a heavy burden of responsibility upon the treasurer. For this reason he is nearly always required to give a bond of surety to indemnify the corporation for any losses arising from misappropriation of funds or from malfeasance in office or carelessness in the performance of his duties. The amount of his bond is most frequently fixed by the board of directors or by the finance committee.

Much of the liability to which the treasurer is open has its origin in common-law rules which, however, have been quite generally enacted into statutes. This liability is for the most part to the corporation itself, but it may also be to the individual stockholders in case these sustain a direct personal loss through his acts. Among the acts of the treasurer that give rise to liability may be enumerated (a) neglect or non-performance of duties and (b) faulty performance of duties, such as incorrect financial statements and reports by the board of directors or by the finance committee.

Secretary. — The secretarial services of which the corporation has need are entrusted to its *secretary* who is elected by the board of directors. He is practically always the secretary of the board as well as the official secretary of the corporation, and very frequently also serves as recording secretary at stockholders' meetings. His manifold duties include among others the following:

1. To arrange for meeting places and to issue notices for regular and special meetings of the board of directors and of the stockholders
2. To make and to preserve accurate and complete minutes of the proceedings of these meetings
3. To preserve the certified copy of the charter of the corporation and of the latest revised by-laws
4. To issue stock certificates as directed and to keep an accurate record of stockholders

5. To have the custody of the corporate seal and to affix it to all documents requiring the official signature of the corporation
6. To cause to be prepared and to transmit to federal and state authorities all official reports required of the corporation.

In the larger corporations this multitude of duties — most of which must be performed on specified dates fixed by the statutes, the charter and the by-laws — necessitates the preparation by the secretary of a chronological schedule. This schedule is called the *corporate calendar*. It is usually in the form of a book, a card index or some other form or memorandum that reminds the secretary that on a specified day he is to perform certain formal matters pertaining to the corporation's official business, such as the mailing of notices for directors' and stockholders' meetings, holding such meetings, preparing and transmitting reports, closing and reopening the stock books, paying dividends, etc. Such a calendar is almost indispensable to a corporation doing a broad interstate business if for no other reason, because of the great number of state reports that are required of it.

For the proper performance of most of the duties enumerated above, the secretary is required to keep separate and distinct records. These with the addition of the books of account maintained by the treasurer, comprise the corporate books. Among them the most important are (a) the minute book, (b) subscription list, (c) stock certificate book, (d) stock ledger and transfer book, and (e) the dividend book.

In the minute book the secretary keeps a record of the proceedings at directors' and stockholders' meetings. Certified copies of the charter and the by-laws are usually inscribed on the first pages of the book. Accuracy is essential in recording minutes because they serve as legal evi-

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dence in court proceedings. In most instances it is found advisable to keep a separate minute book for each body.

The subscription list is merely a record of subscriptions for stock made by stockholders before certificates can be issued. Such subscriptions constitute contracts between the corporation and the subscribers, and the latter remain liable until the terms of the contract are fulfilled.

The stock certificate book is similar to a check book. It contains stock certificates with corresponding stubs consecutively numbered. When a certificate is issued by the secretary there is noted on the stub the name of the person to whom it was issued, the date and the number of shares represented by the certificate. When the shares are transferred the old certificate is surrendered and canceled and a new one is issued. When a certificate is destroyed a new one may be issued upon proof of destruction or loss of the original and deposition of an indemnity bond by the claimant. In small corporations the stock certificate book is frequently the only stock record that is maintained.

The stock ledger and transfer books may be one and the same book, but in some of the states separate books are required by law. Both are intended to preserve an accurate record of the stockholders and of the stock held by them. The ledger must show the names and addresses of the stockholders of record, alphabetically arranged, the amount of stock held and from whom and when it was acquired, and to whom transfers, if any, have been made and when. The balance of stock held by each stockholder as shown by the ledger determines the number of votes to which he is entitled and the amount of dividends that he is to draw. The transfer book consists usually of a record of transfers together with the actual instruments by means of which transfers were effected, bound into book form. The larger corporations ordinarily keep only a record of transfers and leave the other work to special transfer agents and registrars appointed for that purpose.

The rules of the New York Stock Exchange require that the work of registration and transfer shall not be performed by the same agency. The work of the transfer agent consists of examining the endorsements or titles to stock certificates which are transferred from one owner to another. The registrar merely records the transfers and registers the securities that the corporation places on the market. To-day, trust companies make a specialty of both of these services and are usually designated by the secretary of the corporation to act as its agent in these matters.

The dividend book supplies a record of all dividends on all classes of stock that have at any time been declared.

Auditor or Comptroller. — It is neither wise nor desirable that the stockholder should be without some means of checking up on the management of the corporation. This check is usually supplied through a general auditing of accounts. Audits are, as a rule, made annually, quarterly or at irregular intervals. In Europe the auditing must be done by an independent auditor who is usually a government official. But in this country the laws do not provide for independent audits. In the smaller corporations it is the practice to employ public accountants to perform this service as it is deemed necessary. In the larger corporations the auditor, or comptroller as he is also called, is an officer of the corporation. His duties vary greatly from corporation to corporation. Where an auditor is among the officers, the treasurer's work is confined quite largely to custodianship and disbursement of the funds, while the accounting and bookkeeping is in the hands of the former. He is also frequently required to authorize or countersign all vouchers for expenditures before the treasurer may pay out money on them. The whole matter is one of adjustments that are prescribed in the by-laws or by the directors.

Counsel. — Practically every corporation has need of legal services at some time. Large corporations are in liti-

gation most of the time, and they are also constantly in need of legal advice to guide them through the labyrinth of laws which surround them. Most large corporations consequently include a counsel among their officers; while the smaller ones do without an official counsel, but usually retain some attorney to advise them as the need arises.

The whole structure of the corporation, thus, rests upon the principle of a representative type of government after which it is closely modeled. To be sure, it makes use of all of the advantages that the principle of representation offers in a most admirable way; but unfortunately, chiefly because of lack of proper regulation and control by state governments in this country, it has been too frequently utilized for purposes of manipulation, fraud and questionable practices. The next chapter will be devoted to a brief presentation of this aspect of the corporate form of organization.

CHAPTER XI

USE OF THE BUSINESS CORPORATION

THE corporation is today, without question, the favorite form of ownership organization in the United States for business establishments of moderate and large size. This preference was so noticeable among manufacturing establishments in 1909 that it was strongly commented upon in the Report on Manufactures of the Bureau of the Census in that year. This report says: "The most important distinction shown is that between corporate and all other forms of ownership. Of the total number of establishments reported as engaged in manufacturing industries in 1909, 25.9 per cent were under corporate ownership. The corresponding figure for 1904 was 23.6 per cent. While corporations thus controlled only about one-fourth of the total number of establishments, they gave employment to a large proportion of all wage earners reported, namely, 75.6 per cent in 1909 and 70.6 in 1904. The value of the products of the factories operated by corporations represented 79 per cent of the total value of products for all establishments in 1909 and 73.7 per cent in 1904. These figures show that even in this short period of five years the corporate form of ownership increased so greatly that it represented an appreciably larger proportion of the manufacturing interests of the country in 1909 than in 1904."¹ But this growth in the use of the corporate form of ownership for manufacturing establishments, is still continuing. In 1914 the position of the corporation in this type of industry was 28.4 per cent of the number of establishments, 80.30 per

¹ Thirteenth Census of the United States—Abstract (1909), p. 461.

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cent of the total number of wage earners employed and 83.2 per cent of the total value of all products.

Nor is it in the manufacturing industries alone that the corporation is dominant. In mining, transportation and public utilities, and in finance it enjoys an equally eminent position. This is well shown by the following table compiled from the income tax returns for 1917.

NUMBER OF CORPORATIONS IN GIVEN INDUSTRIES COMPARED WITH
NUMBER OF INDIVIDUALS REPORTING INCOME FROM THESE IN-
DUSTRIES IN 1917 ²

Industries in which engaged	Corporation returns				Individual returns Number
	Number showing profit	Number showing no profit	Total number	Percent by indus- tries	
Agriculture and re- lated industr's. . . .	5,633	4,027	9,660	2.7	251,838
Mining and quarrying.	6,371	6,578	12,949	3.7	1,882
Manufacturing.	58,788	20,854	79,642	22.7	22,850
Construction.	7,073	3,670	10,743	3.1	12,791
Transportation and public utilities. . . .	18,673	7,769	26,442	7.5	6,843
Trade.	72,947	18,110	91,057	25.9	134,862
Personal service and professions. . . .	12,160	6,434	18,594	5.3	111,207
Finance.	49,165	19,197	68,362	19.5	3,065
Inactive and not otherwise defined. . .	1,269	32,708	33,977	9.6	33,450
Combination of two or more.					33,738
Totals.	232,079	119,347	351,426	100.0	612,529

² Prepared from Statistics of Income (1917) compiled by the Commissioner of Internal Revenue, U. S. Treasury Department.

Even the field of trade, that time-honored precinct of the individual merchant, is rapidly succumbing to this superior type of organization. Only in agriculture and related

industries and for personal service and the professions does it appear ill suited. There are, nevertheless, many large cattle ranches in the West, and dairying undertakings in the East operating as corporations. It is used but sparingly for personal service enterprises; and it is doubtful whether it can make much headway in the professions, for some of the states, including New York, bar it to the latter entirely.

While the census report, referred to above, ascribes this rapid growth in the use of the corporation primarily to the advantages that it affords in the matter of procuring capital, other factors also have stimulated it. These are of two classes: (1) Those inherent in the type of organization itself, which have already been described in a preceding chapter under advantages of the corporate form; and (2) external influences that favor it in one way or another.

These external forces arise for the most part out of the peculiarities of the present industrial system. Technical progress, for example, has made large-scale production possible by introducing machinery and factory methods into manufacture. But large scale production without an available market and a source of raw materials is of itself not practical. It does not become a factor in industrial organization until the means of communication and transportation have been brought into technical coördination, so that a wide market for finished products and an ample supply of raw materials may be reached. Commercial practices and aids in the nature of finance, extension of credit, etc., also are factors influencing the growth of business establishments. Big establishments then are the outstanding characteristic of modern industry, and since big establishments require large accumulations of capital they adopt a form of ownership organization that can meet this prime requirement with the greatest ease. This the corporation does admirably and with a minimum of risk.

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The policies adopted by the several states with regard to incorporation also, have by no means been negligible factors in promoting its more general use. The sale by state legislatures of special charters has practically ceased, but there still exists among a few of the several states a sort of keen competition to secure the charter-granting business of the country, which, because of the initial franchise tax, can be made very remunerative. It is needless to point out that such competition is conducted on the principle of giving the greatest benefits for the least cost. Consequently, these states encourage incorporation and stimulate it by adopting tax laws under which may be secured the broadest grant of powers with a minimum amount of restriction, control and onerous obligations. Some of the states that have set up "bargain counters" over which to engage in the business of charter selling are New Jersey, Delaware, Maine and West Virginia. New Jersey, which until 1913, had been called the home of American monopolies, for some years preceding that date derived about 60 per cent of its annual revenue for state purposes from its corporation franchise tax—a tax which was no heavier or lighter than was to be found in a considerable number of states but which was gladly paid for holding company privileges and other advantages. The other three states also draw a substantial proportion of their funds from the same source. When, in 1913, New Jersey revamped her corporation laws making them less desirable from the standpoint of "big business," Delaware became its heir. This little state, with a population of but a few hundred thousand, during a single month—July, 1920—granted charters to corporations whose aggregate authorized capital stock reached the staggering sum of \$1,350,000,000 representing 80 per cent of the nation's total for that month.

Even the Federal Income Tax Law of 1918 fosters incorporation by placing a heavier burden of taxes upon

other forms of ownership. Thus, in a letter to the Ways and Means Committee of the House of Representatives in Washington, (March 1920) Mr. Houston, the Secretary of the Treasury said: "In 1918 the members of a well-known partnership paid nearly \$1,125,000 more taxes than they would have paid had their business been organized as a corporation."

So long as the corporation remains the favored type of organization for big business these influences will continue to make themselves felt. Big business demands advantages that the personal ownership types of organization do not offer, and to attain them it will not hesitate to influence legislation to secure the passage of laws under which it may most effectively carry out its operations and plans, whether these may or may not be for the best interests of the public. It is under the pressure of these demands that certain clearly defined types of corporations have been given the statutory sanction, under which they have been molded into shape by the exactions of economic conditions.

Types of Corporations. — Viewed from the standpoint of its structural arrangements, the business corporation exhibits two distinct types: (1) the simple corporation; and (2) the securities-holding corporation.

Where a corporation is authorized to carry on a business undertaking, but is not specifically granted the power to hold or acquire the securities of other corporations, it is a simple corporation. Under the English common law all business corporations are of this type; and under the statutes of most of the several states it is still considered to be the ordinary type. While this does not preclude the simple corporation from establishing certain intercorporate relations, such as interlocking directorates or a community of interest, it does preclude all arrangements whereby a relationship, giving to one corporation a claim to either

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the income or assets of another, or the legal control over it, may be created through the use of securities, particularly of the ownership type.

Such corporations draw their income only from the business plants and equipment, the legal title to which is vested directly in them. Consequently they must operate this economic capital directly, in the same way as an individual proprietor operates his business establishment. Nothing may stand between them and the direct control of the property that they own. It follows, therefore, that they form the organizations that are originally employed to effect the conversion of economic capital into securities that thereupon become available as business assets for the securities-holding corporations.

The preceding chapters that describe the corporate form, its securities, formation, and internal organization refer primarily to the simple corporation. It is more numerous, by far, both in this country and in foreign lands, than is the other type. Numerically, it makes up the great bulk of corporate organizations. But in so far as prestige, power and influence over the business life of the community is concerned, it must concede the premiership to the securities-holding type.

The Securities-Holding Corporation. — The securities-holding corporation — or “holding company” as it is most commonly called in the United States — differs from the simple corporation only in that it is empowered by statute or charter provision to purchase, hold, assign, mortgage, pledge or otherwise dispose of the securities of other corporations. It may thus acquire and own, either ownership or creditor securities or both. When it acquires the ownership type of securities (stocks) it naturally becomes a stockholder, and under most holding company laws in this as well as in foreign countries, it is accorded the same rights and privileges that any other stockholder may possess, including the right to vote.

In the United States the securities-holding corporation first made its appearance as early as 1832, when the Baltimore and Ohio Railroad Company was authorized by special act of the legislature of the state of Maryland to acquire and hold the shares of stock of the Washington Branch Road. From that time on until 1888, when the state of New Jersey first passed a general holding company law, the holding power was sporadically granted by a number of state legislatures. The state of Pennsylvania, for example, by several acts extending over the period from 1853 to 1870 empowered the Pennsylvania Railroad Company to acquire the stocks of other roads. This railroad, by judiciously exercising the privilege, succeeded in building up the extensive network of railway lines that is now known as the Pennsylvania System. However, it was not until 1897, when business began to recover from the effects of the disastrous panic of 1893 and the subsequent years of depression, that the holding company came into general use. Most of the great holding companies that are such a prominent feature of our industrial system were formed since 1900. The United States Steel Corporation with a capital stock of \$1,100,000,000 was formed in 1901; the American Locomotive Company with \$50,000,000, in 1901; the American Agricultural Chemical Company with \$100,000,000 capital stock, in 1899; the American Can Company with \$88,000,000 capital stock, in 1901; the old American Tobacco Company with \$100,000,000 capital stock, in 1904; the American Smelting and Refining Company, in 1901, and the International Mercantile Marine Company with \$120,000,000 capital stock, in 1902. Indeed, the record of holding company incorporations made in the year 1901 has thus far not been surpassed. In that year, in the month of April alone, charters, authorizing the issuance of stock to the amount of \$1,619,000,000 were recorded, chiefly in the state of New Jersey. The great majority of these were for holding companies.

The holding-company clauses that are to be found in the corporation laws of a number of the states today, are of two general types: first, those that grant the holding power to all corporations chartered by the state, regardless of whether it may or may not have been requested; and second, those under which it will be granted only upon a specific request, and upon inclusion of a provision to that effect in the charter. The laws of the states of New Jersey, Delaware, Maine and West Virginia represent the former and those of New York the latter.

The New Jersey law, in effect prior to 1913, was as follows:³ "Any corporation may purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of the shares of the capital stock of, or any bonds, securities or evidences of indebtedness created by any other corporation of this or any other state, and while owner of such stock may exercise all the rights, powers and privileges of ownership, including the right to vote thereon."

In 1913 this section was practically repealed but was restored in substantially its original form in 1920. It is representative of similar laws in other states.

Application of the Securities-Holding Principle.—While the simple corporation effects the primary, or original, "*securitization*"⁴ of economic capital, that includes within the concept both *real* and *money* capital, the holding corporation institutes a secondary "*securitization*" of capital in its widest concept; namely, as including *real economic goods, money and securities*. Because of this diversity of underlying capital, there is a variety of uses to which the securities-holding principle, as embodied in the holding company, may be put. In the first place, it may be employed to effect a subdivision of legal title of ownership in the capital of a business corporation, without

³ General Corporation Law of New Jersey, No. 51.

⁴ The meaning of the word "*securitization*" has been fully explained on page 97.

disturbing the final claim on either the income accruing to that capital, or on the capital itself, as assets. This we shall call simply *subdivision of legal title*. In the second place, it may be used for the purpose of substituting the securities of the holding corporation for the securities of other corporations, in the hands of the stockholders of the latter. This we shall refer to as the process of *securities-substitution*. It may be brought about out of a desire to participate in the income of other corporate enterprises, or because of special problems of financing that are best solved through the medium of a securities-holding organization.

Subdivision of Legal Title. — A corporation that possesses the stock holding privilege frequently finds it advantageous to transfer the legal title to a part of its business capital to another corporation, but at the same time, while so doing, it desires to retain its standing claim on the income, and deferred claim on the assets thus transferred. Its method of procedure in this case is to cause a new corporation to be created and to transfer to it the capital in question, receiving in return therefor all the authorized capital stock of the new corporation. The original corporation is then called a *parent company* and its child a *daughter* or *subsidiary*. It is quite obvious that such a procedure need not affect the unity of purpose of the two corporate entities, for the subsidiary is controlled by the directors of the parent. Neither does it affect the claim on income or assets of the stockholders of the parent because their securities remain unchanged, as also does the aggregate of assets supporting them. Such a transaction cannot, therefore, be called a true substitution of securities.

The United States has proved a very fruitful field for this use of the holding company. The large number of states, each a sovereign judicial jurisdiction, has brought about a condition such that a corporation frequently finds

itself at a considerable disadvantage in doing business in a state other than that of incorporation. In order to overcome these disadvantages it may cause a subsidiary to be created in the state in question. This was the practice followed by the old Standard Oil Trust. In like manner, subsidiaries of this type are frequently organized to take over and operate the foreign branches of corporations. This is common among foreign trade concerns. The General Motors Corporation conducts its Canadian business under the General Motors Company of Canada, Ltd. and its European business under the General Motors Company, Ltd., organized in England. There are in the United States also many concerns created and owned by foreign parent companies. In all such cases the total authorized capital stock of the subsidiary is usually held by the parent company.

The principle of subdivision of legal title is also frequently resorted to in order to facilitate the operation and administration of particular divisions of the business. For instance, the United States Steel Corporation, in 1906, organized the Indiana Steel Company to erect and operate its great plant at Gary, Indiana, and in the same year the Universal Portland Cement Company to take over its cement plants, and in 1917 the Federal Shipbuilding Company to take over the shipbuilding plant erected by the American Bridge Company, which is itself a unit of the Steel Corporation. The General Motors Corporation has in like manner organized the McLaughlin Motor Car Company, Ltd. of Canada, the General Motors Truck Company, the General Motors Acceptance Corporation and others. E. I. du Pont de Nemours and Company similarly organized the Du Pont Engineering Company with a capital of \$7,000,000 to construct a nitrate plant for the government at Nashville, Tennessee, and also the E. I. du Pont de Nemours Export Company to carry on its export trade.

Another use of this type of organization by manufacturing corporations, is to place the legal title of properties characterized by the wasting nature of their assets under a subsidiary. Mining and lumbering enterprises fall generally into this class. It is also found to be useful where an industrial corporation constructs and operates public utilities which, in most of the states, must be incorporated under special laws. Housing and land development undertakings are also conducted under this plan.

The practice of subdividing the legal title to corporate property is, however, very susceptible to abuse and misuse. The extensive use of the so-called "bogus independent concerns" by many of our large predatory corporations, is an illustration of this. Most of these schemes have been devised to circumvent the provisions against restraint of competition, of the Sherman Anti-Trust Law and others. Many examples might be cited to illustrate this particular use of subsidiaries, but a few must suffice. In 1897 the Electric Lamp Combine is reputed to have organized the Royal Incandescent Lamp Company, and took pains to make it appear to be an independent concern. The American Tobacco Company in 1903 organized the Queen City Tobacco Company, and the National Cash Register Company the Universal Cash Register Company for similar purposes.

It must be borne in mind that there is a clear distinction between this type of subsidiary, which is created and owned in its entirety by the parent, and one that has been acquired through purchase of stock from original stockholders. The latter may be accomplished through the medium of securities-substitution, a phenomenon that does not occur in the former case where the distribution of income is effected through the medium of the outstanding securities of the parent company which remain undisturbed by the procedure of subdivision of legal title. Of course,

it is possible for the parent to sell a part of the securities of its subsidiary, retaining only enough to insure control, but such a procedure would hardly effect a substitution of securities. It would amount simply to a conversion of stock assets into cash without reducing the amount of securities of the parent company held by investors who are the final participants in its income. The securities of the subsidiary that are sold to investors would be merely an addition to the sum-total of securities through which income is to be distributed to the ultimate recipients.

Substitution of Securities. — But how different from the above is the effect produced where a new corporation is formed to acquire the securities of other corporations and to place its own in their stead. This is the process of securities-substitution. The concern whose stock is thus acquired is usually called a *subsidiary* of the holding company, when the latter has a controlling interest in it, and an *affiliated* company, if a substantial, but minority, interest is held.

The simplest case of securities-substitution occurs where a holding company acquires the securities of a single subsidiary. Should the holding company possess all of the subsidiary's securities and issue in their stead a like amount of securities that are identical in all respects, the substitution cannot be said to have any marked effect on the distribution of income or control over business capital, for the ultimate supporting capital back of the new securities would be that which was back of the old. In order to bring about any change in income distribution in a case such as this, there would have to be some difference between the two securities. For example, the holding company might substitute a limited dividend, non-voting preferred stock in place of most of the common stock of the old company, while the small amount of its common stock is held by the promoters for purposes of control or enjoyment

of all excess profits. This might conceivably be of advantage to the promoters, but of disadvantage to the body of stockholders generally. Indeed, such operations as these are most frequently undertaken for purposes of financial manipulation in order to bring about an artificial rise or decline in the market value of the securities to the profit of the promoters. However, this is usually only a temporary expedient that results finally in the complete dissolution of one or the other corporation.

Because of the great number of concerns frequently involved, the practice of securities-substitution, as employed in modern business, presents a much more complex problem than that above outlined. Where two or more subsidiaries are involved in a securities-substitution operation, the inevitable result is an economic combination of the basic or underlying capital, a legal combination of the income derived from that capital and a possible control over it.

Consolidation of Corporations. — In the financial world the term *consolidation* is used to signify the process of bringing a number of existing corporations, or their business establishments under the control and direction of a single corporation. It may be effected through stock ownership or fusion. In the former case the controlled units retain their legal entity as corporations, but in the latter, they are dissolved and their business establishments become the direct property of the combination unit. Fusions may be made either through merger or amalgamation, a process which may or may not involve the substitution of securities.

A *merger* takes place when one ownership organization absorbs the properties, real and personal, assets and business of one or more other organizations that are thereupon dissolved. Thus, if of the three companies A, B, and C, the former, Company A, should acquire by merger the properties of companies B and C, company A alone

would retain its identity while the other two would disappear entirely. The absorption of the Central District Telephone Company by the Bell Telephone Company of Pennsylvania illustrates this principle. The latter company was incorporated in 1879 as the Bell Telephone Company, of Philadelphia and its name changed to the present title in 1907. In 1918 it acquired the properties and business of the Central District Telephone Company and assumed its funded debt outstanding.

An *amalgamation* occurs where a new organization is formed for the specific purpose of taking over the properties, assets and business of existing units, thereby leaving the newly formed unit as the only existing entity. Thus, in 1896, the New York Telephone Company was incorporated to acquire the properties and business of the Metropolitan Telephone and Telegraph Company and the Westchester Telephone Company. And more recently, in 1911, the Mountain States Telephone & Telegraph Company was formed to absorb the Colorado Telephone Company operated in Colorado and New Mexico and the Rocky Mountain Bell Telephone Company in Utah, Idaho, Montana and Wyoming. The amalgamation was effected through the acquisition by the new company of the stock of each of the constituent companies, and with the transfer to it of all the physical properties, franchises, etc., of the former companies, which were thereupon dissolved.

However, in practice little attempt is made to differentiate between these several methods of consolidation, and the terms "amalgamation," "merger" and "consolidation" are frequently used interchangeably.

Prior to the general adoption of the holding principle in ownership organization, the merger and amalgamation were resorted to to combine existing units on a large scale into a single large operating organization. Such was the method employed in forming the old United States

Leather Company in 1893 with a capitalization of \$120,000,000, consisting of \$60,000,000 common and \$60,000,000 preferred stock. The old United States Cordage Company, the National Starch Company and the American Malting Company likewise were the result of merger operations. It was also employed in the formation of the Standard Oil Trust of 1882.

The earlier consolidations were usually effected without the use of the holding company. In the later ones, however, the process has frequently begun through the acquisition of a small amount of stock by the absorbing unit which, by gradually increasing its stockholdings soon becomes the sole stockholder and thereupon votes to dissolve its subsidiary. This practice has been common among our industrials, and particularly with the General Electric Company. This company at the time of its formation in 1892 arose out of an amalgamation of the Edison General Electric Company, the Thompson-Houston Electric Company and the Thompson-Houston International Electric Company. By 1902 the General Electric Company had acquired all of the capital stock of the Sprague Electric Company, and a year later of the Stanley Electric Manufacturing Company which were then merged with it and dissolved. In 1912, the company similarly dissolved the National Electric Lamp Company and its subsidiaries and merged their properties with its own.

To bring about a consolidation of this kind requires either an outright sale of the business and its properties to the absorbing company, or the possession by it of all the outstanding shares of stock of the companies that it desires to consolidate. These conditions militate against its more general use in this country and tend to favor combinations bound together by means of holding companies that own a majority of the stocks of their subsidiaries. But in European countries, especially in Germany, it is still the favor-

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ite means of building up the modern great business units. Since the war it has played a prominent part in forming the gigantic combinations that have sprung up in the German steel, chemical and electrical industries, although the holding company principle seems, also, to be gaining favor.

However, further explanation and description of specialized uses of the modern corporation would lead into a discussion of securities-substitution companies and combination organizations. Before going into these subjects it will be necessary to explain the voluntary association in the form of trust, as a type of ownership organization.

CHAPTER XII

THE BUSINESS TRUST

General. — It is a well recognized principle of common law that a person may temporarily vest the legal title to property together with the exclusive right of its management and control in another as trustee, reserving for himself or others only the profits or benefits that may accrue to such property while under the control of the trustee. Such an act creates a trust estate. The principle has its origin in the right of private property and inheritance, and in its simplest form, it is employed as an instrument of the courts to preserve property conveyed, as by will, to minors during their minority. It is of importance in this work inasmuch as it has come to be used as a form of organization for the conduct of business enterprises.

Definition. — The business trust may be defined as a business estate in the custody of a trustee, who holds the legal title thereto with the beneficial interest in others who are the beneficiaries. The settlors, or creators, of a trust embarked in business may be the sole beneficiaries where they contract with each other as to how, severally, they may acquire that status.

Trusts are essentially of two types, *active* and *simple*. In the simple or "dry" trust the title to the property is vested in a trustee for the benefit of another without stipulating or prescribing in the contract the nature of the trust, but leaving this matter to the construction of law. In the active trust, the founder or settlor prescribes in the trust agreement the conditions under which the trust

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is to be conducted, leaving to the court of equity only the duty of enforcing the terms of the agreement in order that the purpose for which the trust was created may not be frustrated. It is the active trust that is employed for the conduct of business.

The structural elements of the business trust may now be summarized as follows:

1. The *settlers* who draw up the agreement making a trust estate of certain business property and defining the manner in which such property is to be owned and managed and what disposition shall be made of it

2. One or more *trustees* whom the settlers vest with the legal title to the property and with the power of management and control over it subject to the provisions of the trust agreement

3. The *beneficiaries* who are defined in the trust agreement, who possess the equitable interest in the trust estate entitling them to the net profits accruing to it and who usually have the power to fill vacancies on the board of trustees.

Formation. — As seen from the preceding paragraph, a trust embarked in business is the result of a contractual agreement between the settlers and the trustees. The rules of common law, in general, give to the settlers the right to place property in trust and to specify the conditions that shall govern its control and management. Thus the instrument creating the trust, commonly called the *trust agreement*, is to this form of business organization what the charter is to the corporation, or the articles of association to the joint stock company, namely, its fundamental grant of rights and powers.

Since a state may not generally limit the freedom of contract for a purpose other than to protect the public health safety or morals, it follows that the trust agreement may provide for practically any form of organization that

places the legal title in the trustees and reserves the benefits to others. Practically the only limitation placed upon the conditions of the trust agreement is with reference to permanence. In practically all states the rule against perpetuities is applied to trust estates. There are no laws prescribing procedure, or limiting the number of settlors, trustees or beneficiaries. In fact, as great a latitude exists in the matter of drafting the details of organization for the business trust as obtains in the ordinary partnership.

THE TRUSTEES

Of the three elements that go to make up the organization of the business trust—settlors, beneficiaries and trustees—the trustees are responsible for the management and direction of the trust estate, the settlors merely make the contract creating the trust and disposing of the estate at its expiration, while the beneficiaries have the equitable interest in the profits.

Trustees as Managers.—The power of management and direction of the trust estate vested in the trustee under a dry trust, is determined by common law rules. These rules place upon him the same responsibility as would apply to an individual proprietor, or to ordinary general partners in cases where there are several trustees. It thus includes full and unlimited liability on all contracts entered into on behalf of the trust estate and full and unrestricted power of management and control, but exercised under the general supervision of a court of equity whose duty it is to see to it that the purpose of the trust is fulfilled. The trustee cannot delegate to another any part of his discretionary power, that is, his responsibility for final determination of contractual rights and duties. He may, assign to others, however, the performance of purely ministerial duties, but is always responsible for their acts in like manner as a principal is responsible for the acts of his

agent. The bar against the delegation of discretionary power is on the theory that the trustee is not an agent, but is himself a principal and the court, therefore, refuses to recognize the responsibility of any one other than the trustee. Where there are two or more trustees, they must act jointly, as a unit, in all discretionary matters.

However, these general rules of law, that are applicable in case of a simple or dry trust may be considerably altered in active trusts by the introduction of specific provisions into the trust deed or agreement. In this way the trustees may be authorized to delegate general managerial power to others; and it may also be provided that a designated majority of the trustees shall have power to act for and bind the trust estate. However, all such instruments will be strictly interpreted by the courts. Thus, where a majority is authorized to govern, it is ordinarily held that they are not thereby empowered to act without consulting the others, who must at least be given an opportunity to be heard. As a result of these general rules a high degree of coöperation, such as might obtain in a well ordered partnership, is essential where there is more than a single trustee.

Appointment of Trustees, Removal, Successors. — In an active trust the original trustee, or trustees, are appointed by naming them in the trust agreement to which they become parties. Other than the natural minimum limit of one, there is no rule prescribing the number of trustees that may be appointed. This is left entirely to the settlors, who, of course, should bear in mind the impracticability of a large number in view of the requirement for joint action.

The term of office of trustees may be prescribed by the trust deed, but it cannot extend beyond the legal life term of the trust. Where trustees are several in number it is a common practice to classify them. For example, in the old Standard Oil Trust nine trustees were appointed and

the term of office was fixed at three years, but they were so grouped that three were to be elected annually by the beneficiaries. This arrangement for the selection of successors of trustees is common with many business trusts, each beneficiary being accorded a number of votes commensurate with his share of the beneficial interest in the trust. If no specific provisions are made for the appointment of trustees' successors that power lies exclusively with the court of equity.

Since the trustees are themselves principals and not agents of the settlors or the beneficiaries it follows that the latter ordinarily do not possess the power of removal of trustees. But any one of the beneficiaries or trustees may appeal to the court which will remove the accused trustee when sufficient cause for removal has been shown. It has also been held valid for the beneficiaries and one trustee, acting together, to remove another trustee for sufficient cause where provision for this was made in the trust deed.

It is thus fairly well established that the creators of the trust may stipulate in the trust agreement how trustees and their successors are to be appointed and removed, and that an arrangement similar to that used in the election and removal of directors of a corporation may be employed.

Liability of Trustees. — The nature of trusteeship places upon the trustees a two-sided liability, namely, toward the creditors of the trust and toward the beneficiaries.

Toward the creditors the trustee's liability, in the case of the simple or dry trust, is unlimited. Where there is but one trustee, his liability is identical to that of an individual proprietor, and where there are several, they are treated in this matter like ordinary partners. The creditors look to the trustee personally to satisfy their claims, but the latter may reimburse himself out of the trust estate for all legitimate losses. If the trust estate is insufficient to

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repay him fully for the sums paid to creditors, the balance remains as a personal loss, for it cannot be passed on to the beneficiaries. It is customary for trustees of dry trusts to stipulate in all business contracts entered into on behalf of the trust, that the trust estate alone shall be bound as pledge for the debt, and in this way to relieve themselves somewhat from the onerous burden of unlimited liability.

The rule concerning trustees' liability in active trusts follows that described as applicable to a dry trust in all cases where the trust agreement, or deed, does not definitely and specifically limit it. Where the trust is embarked in business, the liability of the trustee is frequently limited by the deed of trust, so that the trust estate only is bound for any debts incurred on behalf of the trust. When this is done the trustee is usually required to show how much of the trust property is encumbered, and what portion is free. Then, by inserting in all contracts that the trust estate alone is to be looked to for satisfaction of creditors, he cannot himself be personally liable, except in case of fraudulent concealment of the true condition of the estate.

The trustee's liability toward the beneficiaries arises out of the circumstance that he is in a fiduciary relation to them. For in spite of the fact that the legal title to the trust property is vested in him, he is, nevertheless, still liable to the beneficiaries for any losses suffered by the trust estate as a result of his culpable negligence or fraudulent action, because such acts may directly damage the beneficiaries by reducing the benefits to which they hold the equitable title. Thus, where the trust estate has suffered loss under these conditions, the trustee is personally liable and will be required by a court of equity to reimburse the estate.

Where there are several trustees all are held to be jointly liable for the valid acts of any one of their number. This

is on the theory that there is no such thing as an inactive trustee. Consequently, it makes little difference whether or not all had knowledge of and gave assent to the binding acts, they are nevertheless liable. The same rule has been held to apply with equal force where fraudulent or culpable acts had been committed by one trustee to whom the others had left the direction and management of the trust's affairs. The trustees may, however, protect themselves by active participation in the trusteeship and through voicing a negative vote in such matters.

Right to Sue and be Sued. — An action at law by or against a trust embarked in business ordinarily must be brought by or against the trustees. The beneficiaries usually need not be brought into the action, where a personal judgment is sought against a trustee or by him on behalf of the trust, although in a few states by a limited number of cases, it has been held that the beneficiaries should be joined with the trustees in the suit. This contention is strengthened where the very existence of the trust is at stake. It should be noted, however, that, in a business trust where the beneficiaries gain their status by virtue of ownership of transferable shares, there are serious practical difficulties standing in the way of joining them in actions. The rule in these cases seems to favor omitting them.

The judicial jurisdiction in which suit may be brought is also of importance at this point. In statutory trusts, or such as are created by court appointments, it is held that action must be brought within the jurisdiction of the supervising court. In the case of contractual trusts, such as business trusts are, the trustee if he is a citizen may sue and be sued as any other citizen in whatever court's jurisdiction he may happen to be.

The general character of the liability assumed by the trustee is such that he can easily protect himself against

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loss arising from liability for any lawful act on his part. Every form of insurance is open to him, and he is a stupid trustee who does not protect himself by taking out fire, cyclone, indemnity, fidelity, and like types of insurance. For culpable and fraudulent acts there is, of course, no protection; the law will take its course and fix liability upon him for such acts.

Relation to Court of Equity.—A trust estate is constantly under the supervision of a court of equity with which the final power of direction rests. While the trustee may do any lawful act generally authorized by the trust agreement, this rule is not construed to restrict his sphere of action to such things as he may have been specifically authorized to do. If an act not specifically authorized but necessary to preserve or make the trust effective, is contemplated by the trustee he may apply to the court of equity for direction. This, when given, constitutes full authority, regardless of what may be its results. But of course, this does not mean that the trustee may appeal to the court to decide every point that may come up. It must be a matter of some importance.

Compensation of Trustees.—The trustee is entitled to receive any compensation that may be agreed upon in the trust deed. But where no agreement concerning compensation has been made it is held, according to the American rule, that the trustee shall be entitled to a reasonable compensation for his services. The court may also set the amount at a sum that will make it possible to secure some person to act as trustee who is qualified to fill that position and to give effectiveness to the trust.

THE BENEFICIARIES

The beneficiaries are the entrepreneurs of the trust estate. They are said to have the equitable title while the legal title to the property is vested in the trustee.

Their status is very like that of partners without any liability or power of management and direction. Their entrepreneurial function is something less than even that of the dormant partner. In fact, the sole entrepreneurial elements to be found in their status are a standing claim to that part of the income of the trust not otherwise claimed by creditors and sometimes, though not always, a deferred claim to share in the distribution of assets upon dissolution of the trust after preferred claimants have been satisfied. Since their claims are last claims, they have assumed at least a large share of the element of risk, which, coupled with the power to appoint and remove trustees and to terminate the trust, frequently given them in the trust deed, would seem to entitle them to be considered as entrepreneurs.

In the business trust, the interests of the beneficiaries are usually embodied in securities, called trust certificates. This feature, combined with the rights and powers ordinarily given to the beneficiaries by the trust agreement, places them in a position with relation to the trust which is very similar to that of the stockholders to the corporation.

Rights and Powers of Beneficiaries.—The rights and powers of the beneficiaries are fairly well defined under common law practice as interpreted by court decisions. Within these absolute limits they may be modified by provisions inserted into the deed of trust by virtue of which the beneficiaries gain that status. They will be considered here only in so far as they apply to trusts created to carry on a business.

1. Each beneficiary has the right to demand and receive his proportionate share of the benefits or profits accruing to the trust estate as provided in the deed of trust. He can dispose of his share as he pleases after once having received it. There are also cases on record which seem to sanction his right to anticipate his income from the trust

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and to pledge it; but usually this cannot be done irrevocably. Where all of the beneficiaries agree that the accrued profits shall be reinvested they may thus add to the trust capital. As a general rule, the beneficiary takes the full legal title to the accrued income at the moment that it should be paid over to him, because beyond that time there would be a wrongful withholding by the trustee.

2. He has also the right to demand reimbursement to the trust estate for any losses thereto arising out of fraudulent, culpable or wrongful acts of any trustee. Thus, if any loss is sustained by the trust estate by any wrongful or unlawful act of a trustee, such trustee may be sued in a court of equity and judgment secured by the beneficiary requiring the culpable trustee to restore the trust estate.

3. He has the right at all times to be informed concerning the management and the condition of the trust. He may demand of the trustees a complete statement of the accounts and finances of the business at all reasonable times. This right is usually set forth in the trust agreement by requiring the trustees to render periodic statements and reports on the condition of the trust and to transmit copies to each of the beneficiaries.

4. He has the right to claim non-liability for any acts of the trustees. The creditors cannot look to him for the satisfaction of any claims not fully met out of the trust estate.

5. He has the right to appeal to a court of equity to have an incompetent trustee removed. In such an action he may act without joining in with the other beneficiaries. Removal of a trustee through such action will be ordered by the court only where the beneficiary presents evidence showing the existence of sufficient cause.

6. The beneficiaries as a body may reserve to themselves the right to elect successors of trustees and to remove trustees for cause where it is so provided in the trust agree-

ment. In such cases the method of voting to be employed is prescribed in the agreement. Where the beneficiary's interest is represented by transferable trust shares, or certificates, he usually has one vote for each share owned.

7. In the ordinary type of business trust, wherein the interest of the beneficiary is represented by transferable shares, it is common to insert in the trust agreement that the trust may be terminated at any time through the acquiescence of a specified majority of shareholders. However, where such provision is not incorporated in the trust deed, the beneficiaries would not possess power to terminate the trust.

Liability of Beneficiaries.—The liability of loss, or business risk, assumed by the beneficiary of a business trust has an absolute limit. He may lose only what he has contributed to the trust estate either as an original settlement, or as subsequent additions to the trust estate through new contributions or conversion of profits. Of course, where he is not himself a settlor, but simply a gratuitous beneficiary, he assumes no risk of loss of any capital that he may have had at the time of the creation of the trust. The right of creditors to satisfy their claims out of the trust estate and the personal estate of the trustee does not usually involve the beneficiary. His liability is even less than that of the stockholder in a corporation, who, if he pays less than the par value of stock, may be called upon by creditors in case of insolvency to make up the difference between what he has actually paid and the par value of the shares that he subscribed to. In the business trust, on the other hand, he risks only what the trustee has actually received from him, and not what he may have agreed to contribute.

Transferability of Beneficial Interest.—The beneficiary of the business trust generally has the same privilege of divesting himself of his equitable interest in the trust estate

as has a stockholder in a corporation to sell or give away his interest in the corporation. But this privilege may be limited by a trust agreement or deed to be exercisable only after the beneficiary has received his profits, and so may not allow him to divest himself of the title to the benefits. An arrangement such as the latter would obviously interfere with the freedom with which he may deal with his equitable business property. However, this is a rare exception to the general rule.

The usual medium employed to make the beneficial interest in a trust freely transferable are securities. These securities, called *trust shares* or certificates, carry with them a standing claim on the net income of the trust and a deferred claim on the assets of the trust estate. They ordinarily have no face or par value, and resemble very closely non-par value stock. The assignment of a nominal par value to them is not prohibited, but as it is practically meaningless, it can serve no purpose other than that of being a convenient basis upon which to distribute the earnings. Special preferences may be represented by preferred shares, similar to those of the corporation. In fact, all of the niceties of participation adjustments to be found in corporate securities may be freely employed in the trust.

THE TRUST CAPITAL

The original capital of a trust embarked in business consists of the property, real and personal, that the settlors actually conveyed to the trustee. The divestment by the settlors of the legal title to the property must be absolute so long as the trust is to last. They may in no way retain control over it while it remains a trust estate. The trustee, as before stated, has the legal title to this capital and the absolute control of it. Thus he may deal with it in what-

ever manner he believes will best accomplish the purpose for which the trust was created, being limited in this only by such specific stipulations as may be found in the deed of trust.

It is not necessary that the capital be preserved in the form in which it originally was when the trustee received it. In a trading trust created to derive a profit from the purchase and sale of commodities this is self-evident. The New England real estate trusts are also usually empowered to buy, hold and sell parcels of real estate. In fact, it is not uncommon to authorize trustees of business trusts to convert the properties into cash for reinvestment in other enterprises. Hence, capital devoted to business undertakings under the trust form of ownership organization need be no less fluid than under any other type of organization.

The trust capital is not capitalized in the same sense as that of the corporation. In the latter type of organization, as we have seen, the capitalization is measured by the sum total of outstanding securities, where these have an ascribed par value, and if the assets do not equal this in value the items in the balance sheet must in some way be inflated to bring about a balance. However, in the trust, the capitalization would conform more closely to a figure arrived at by capitalizing the net income or earning capacity, as no authorized capital need be taken into account. Even where a par value is ascribed to the trust securities, this is a meaningless fiction; for the creditors as well as the beneficiaries may demand of the trustee a statement showing the actual condition of the trust estate. Any error in such a statement arising from intent or undue negligence on the part of the latter renders him personally liable for losses sustained by others acting in full faith upon its correctness. The trust estate, where such power is given in the deed of trust, may be pledged as security for issues

of bonds of both the mortgage and debenture types almost as freely as in the case of corporations, with similar rights to the bondholders.

RIGHTS OF CREDITORS

The creditors of a trust have no direct rights enforceable against the beneficiaries although they may acquire title to the latter's equitable right to the benefits. However, this, as well as their other rights, are more directly against the trustee and the trust estate. These rights are greatest in the simple or dry trust. They may be summarized as follows: (1) They have the right to seek satisfaction out of the personal estate of the trustee which, of course, legally includes the trust property, and they may sue the trustee in person to recover, leaving it to the latter to reimburse himself out of the trust estate. (2) Unless otherwise provided, a creditor also has the right to demand proof that the property sold to the trustee has actually been applied by the latter to the purposes of the trust. (3) In case of insolvency of the trust the creditors may take the place of the beneficiaries or share with them in the benefits of the trust while the property remains in the hands of the trustee, who thus becomes trustee for the creditors. (4) They may appeal to the court of equity that has jurisdiction over the trust to have the assets liquidated and the proceeds turned over to them; in which case they all share ratably, since no preference may be granted.

The general rights of creditors as above outlined are broadest in the simple or dry trust, but most of them may be considerably narrowed by provisions inserted into the trust deed. This practice is commonly followed in agreements creating business trusts. For instance, the first right mentioned is usually so limited that the trustee pledges only the trust property to support creditors' claims; the second may be entirely eliminated; but the others ordinarily hold.

OTHER TRUST FEATURES

Duration.—It is a cardinal principle of common law that no property shall permanently be withdrawn from commerce. It is called the rule against perpetuities, and is interpreted by courts to mean that no person may, except by express authority of statute, suspend his power of alienation over his property. The application of this principle to trusts has been clearly stated by a New York court which said: "The mere creation of a trust does not, *ipso facto*, suspend the power of alienation. It is only suspended by such a trust, where a trust term is created, either expressly or by implication, during the existence of which a sale by the trustee would be in contravention of the trust."¹ But this is further modified in that "It is only in cases where other parties besides the person creating the trust have an interest therein that the trust becomes irrevocable."²

This rule has a direct bearing upon the duration or term of years for which a trust may be created without vesting the power of alienation in the trustee. Such limitations are fixed by statute in many of the states, but vary considerably. Thus, in some jurisdictions, the term of lawful suspension is measured by a life or lives in being, in others by twenty or twenty-one years, and in still others by the two combined. However, it should be pointed out that there is no suspension of alienation where the settlors are the sole beneficiaries, and also where the trustee is given the power to sell the trust property with direction to reinvest it. Hence, in the first case, the life term of the trust would be limited, while in the latter it may continue indefinitely.

¹ *Roberts v. Corning* (1882), 89 N. Y. 225.

² John H. Sears, *Trust Estates as Business Companies*, p. 131.

Scope of Activity. — The business trust is a common law organization constituted by contractual agreement. Consequently it is not restricted in the scope of its activities, except where it may be against public policy or statutes. It may be employed to conduct any kind of business enterprise and may change from one enterprise to another where provision for this is made in the agreement instituting it. In this respect, therefore, it resembles the personal ownership types such as the partnership; as well as the corporation; for, where the settlors are the sole beneficiaries, the deed may be changed by agreement, but where others than settlors have secured rights under it, the terms of the deed bind.

Taxation. — It is a generally established principle of law that the legal and equitable interest in the trust shall not both be taxed. Taxes must be levied against either the one or the other. In most of the states the statutes provide that the tax against the trust property shall be levied against the trustee. Where there are several trustees residing in different jurisdictions the usually accepted rule is that the real property shall be taxed in the jurisdiction in which it is located and the personal property in the jurisdictions in which the trustees reside. In order to avoid double taxation of personalty under this rule, the tax is ordinarily pro-rated among trustees residing in different tax jurisdictions. Thus, it is seen that the beneficiaries and the trustees may not both be taxed, a principle that gives the trust quite an advantage over the corporation. The latter is itself taxed on its franchise as well as on its property and income, and its stockholder is also taxed on his stock.

Dissolution. — The trust may ordinarily be dissolved by accomplishment of its purpose, by expiration of its term, by volition and by decree of the court of equity. The first two of these causes need no further explanation.

Voluntary dissolution of a trust can be effected only by agreement of the parties thereto or as provided in the agreement creating it. Where the settlors are the sole beneficiaries they are empowered to dissolve it at will; but where third parties have secured rights by virtue of it, their consent would be necessary. Where the purpose of the trust is injurious to the public welfare, the court may cause its dissolution by so decreeing. Bankruptcy is not a cause for dissolution. A trust of itself cannot become a bankrupt. The usual procedure in case of insolvency is for the creditors to become beneficiaries and as such to petition the court to dissolve the trust and to apportion its assets among them.

BUSINESS USES AND TYPES

The trust is without doubt the most versatile of all types of ownership organization in business. In it may be combined all of the best features of the personal ownership and the securities-issuing forms. Thus, persons engaged in business under a trust have the advantage of the minimum of restriction to be found under common law to the same degree as partners; they have the limited liability of stockholders in a corporation, and their enterprise may have the same flexibility as the corporation through the use of securities to represent the claims on income and assets. Hence, in its most highly developed form the business trust is essentially a securities-issuing type of organization. As such it is adaptable to business undertakings of the largest kind as is well illustrated by the famous Standard Oil and American Sugar Trusts, declared to have been illegal by the courts, and the somewhat less famous but legal trusts of Massachusetts.

The Trust Agreement. — What the trust agreement of a securities-issuing trust embarked in business should contain will depend largely upon the result sought to be accom-

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plished and the few statutory limitations that are found in the several states. There are, however, some general rules of law that should be observed. An admirable set of directions covering these essential rules has been drafted by Mr. John H. Sears,³ and is given below.

" 1. The trust instrument should fix the term of duration of the trust, or its earlier cessation by prescribed action, as say by a vote of two-thirds of its certificate holders. The limit within which this term may continue and its form of expression are referable to local law, as explained.

" 2. The particular business to be conducted should be stated with enough of precision to notify those who deal with trustees as to the extent of their powers.

" 3. The instrument, to resolve all doubt as to its creation of a trust, should, along with the vesting of legal title, commit to the trustees the absolute control of the trust property, with full power to make it answerable for their acts and contracts in the conduct of the business of the trust. Any power of removal or change of trustees should exclude any right to invalidate prior contracts, or repudiate responsibility for prior acts, within the apparent scope of their powers.

" 4. The particular property of which the trust estate is to consist, in its original form or as afterwards to be invested, should be described so as to admit of ready identification and by apt words the legal title should be vested in the trustees and their successors.

" 5. The right of trustees to act singly or by a majority or collectively, either generally or specially, should be set forth, and whether or when their contracts should be in writing, or, if oral, what ratification, if any, of a single trustee's acts should be required as a condition precedent to their validity. Also a collective name may seem to be

³ *Ibid.* pp. 249-251.

of advantage to a trust. If so, the trust instrument should adopt the name, with such signing and counter-signing as it may seem advisable to prescribe.

“6. The trust instrument should vest specifically in the trustees the right to stipulate for personal exemption from liability in making of contracts, the right to indemnity out of the trust where they may be held personally liable, and the right to pledge the trust property for their contracts, and it should contain a clause for exemption of certificate-holders from personal liability. It should be provided that all written contracts should contain these features, so as to bring them to the notice of parties contracting with the trustees.

“7. The instrument should provide how many shares, and the different kind of shares, if any, in a trust are to be issued, their transfer and how evidenced, that they are personal property to pass by succession as other personal property and that the death of a holder shall not affect in any way the continuance of the trust, nor such death give to any person any right for an accounting or partition.

“8. Provision for meetings of shareholders, regular or special, election, removal or change of trustees, filling vacancies, investigation into the affairs of the trust and reports to shareholders, and for amendments of the trust instrument. What right of inquiry a certificate holder should have, of his independent motion, might be thought advisable to be stated, as well as under what circumstances it may be exercised. It is suggested that, if there is a fair reason for independent inquiry by a certificate holder, this could be made plain to a reasonable number of shareholders, who could join in a request and this right thus not become liable to abuse, as has been alleged in regard to the exercise of such right by a stockholder in a corporation. The place of a business should be stated.

“9. Care is to be taken that in change of trustees the

trust instrument specifically should provide that their successors succeed to the same rights and powers and are subject to the same duties and liabilities and have like compensations as the former trustees.

"10. All instruments of trust should merely by way of caution, make specific provision that in no instance need anyone dealing with the trustees have any obligation, either in law or equity, resting upon him to look after the application of any trust funds or property coming into the hands of the trustees. This caution is in view of an old doctrine, about purchasers from trustees seeing to the application of purchase money to purposes of the trust. Such a provision takes away all question as to intent of settlors in this regard."

Types. — Three types of business trusts have come into more or less general use. These are (1) operating trusts, (2) holding or combination trusts and (3) investment trusts. The distinction between them is largely found in the purpose for which the trust is organized.

Operating trusts are organized to carry on a business directly through the operation of a business plant and equipment by the trustees and their duly appointed agents. This type is well represented by "The Massachusetts Gas Companies" a trust organized by New York and Boston bankers to carry on the business of supplying coal, gas and their by-products, etc., to Boston and other New England cities. A copy of this trust agreement, which deserves careful study, may be found in Part VI of this volume. Prominence has also been given to it by the so-called "Real Estate Trusts" which are common in New England. Their purpose, in general, is to buy, hold, improve and sell real estate, a business which cannot, because of statutory prohibition, be carried on by corporations. In the city of Boston, alone, these real estate trusts own property whose value is considerably more than \$300,000,000. The tax

commissioner of the Commonwealth of Massachusetts in his report to the legislature in 1911 commenting upon the serviceability of trusts of this type, says: "The right of shareholders, the terms of office of trustees, their compensation, powers, duties, and limitations are more satisfactorily regulated by the terms of the trust agreement, which can be drawn to meet the special needs in each case, than could be possible under the general corporation laws."⁴

The *holding trust* is an outgrowth of the voting trust so frequently employed by stockholders of a corporation to conserve some special interest by combining their voting power. It is at once clear, where the majority of the voting stock of several corporations is placed in the hands of the same trustees as a single trust estate, that the trustees would thereby become empowered to control the corporations whose stock they thus hold by electing directors who will carry out their wishes, or by electing themselves to those positions. The capital of such a trust consists chiefly of securities which are constituted a trust fund not for the purpose of conducting or operating any particular business enterprise, but to serve merely as a convenient form of organization to control the activities of operating units that were already established or were subsequently to be established. They are, pure combination organizations seeking to harmonize and unify the business policies of the units that they control. Where the controlled units are corporations, it has been held by the courts, that such holding trusts are illegal because corporations may combine only as permitted by statute, and in such instances committed an act *ultra vires* by themselves becoming parties to the agreement.⁵ In a subsequent case where the corporations themselves were not parties to the agreement the court, nevertheless, held that the separate entity of

⁴ Mass. Acts and Resolves, 1911, ch. 55.

⁵ *State v. Standard Oil Co.*, 49 Ohio St. 137 (1892), and others.

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the corporations had been disregarded and the agreement was illegal.⁶ But when statutory authority is granted, holding trusts that control corporations are quite legal, as is also the case if the controlled organizations are of the non-corporate type.⁷

The *investment trust* is like the holding trust in that the trust fund consists chiefly of securities, but it differs from the latter in its methods and purposes. While the purpose of the holding trust is control over other organizations, that of the investment trust is to reduce to a minimum the risk of loss arising out of ownership of securities. The method followed in constituting such trusts consists essentially of creating a trust fund on shares and utilizing this to purchase securities of a large number of enterprises so that the beneficiaries, or shareholders, will receive an average profit rather than to run the risk of fluctuations in dividends. In other words, they seek to reduce the unequal earnings of many undertakings to a uniform average rate and thereby to reduce the small investor's risk. This type of organization first came into prominence in England during the decade 1870-1880 when a considerable number of these trusts were organized.

Speculative securities-holding trusts very much like the investment trust are also to be found, chiefly in England. They differ from the investment trust in that their operations consist of trading in securities thereby deriving an income from the purchase and sale of securities and not primarily from dividends.

⁶ *U. S. v. Standard Oil Co., of N. J.* (1911), 221 U. S. 1, I. C. 41.

⁷ For a trust agreement illustrating this type see that of the Standard Oil Trust given in Part VI of this volume.

PART IV
COMBINATION ORGANIZATIONS

CHAPTER XIII

BUSINESS COMBINATION: ITS CAUSES AND FORMS

THE phenomenon of combination of entrepreneurial units, even to a point little short of complete monopoly, is perhaps the most characteristic feature of modern industrial organization. This movement, which became important about the middle of the last century, has been experienced in all the industrial countries of the world; but it has been most pronounced in the United States, Germany and Belgium and less so in England, France and other European countries. In the United States it is found to exist and to flourish in practically all of our basic industries, and it is now making its appearance in the field of trade, even including retailing. We find it among our railroads, ocean transportation companies, public utilities, the mining, steel, and petroleum industries, construction, manufacture of automobiles, chemicals, powder, tobacco, sugar, electrical equipment, etc., as well as in the meat packing industry, horticulture, lumbering and fishing. In fact, there are but few industries in this country in which the phenomenon of combination is absent or where attempts to introduce it have resulted in failure, as for example, in the manufacture of cotton yarn and textiles, starch, malt, rope and twine and in the production of table salt.

It is this movement toward combination that has induced Congress to enact the Interstate Commerce Act of 1887, and the Sherman Anti-Trust Act of 1890, and subsequently to strengthen them with supporting legislation. The several states also attacked the movement with

anti-combination, anti-pool and anti-trust laws. But the economic forces back of it have been so strong that most of the great combinations existing in this country today have been formed in the face of these laws, though some of them have been held by the courts to be in violation of the statutes against monopolies, combinations in restraint of trade and conspiracies to raise prices, and were ordered to dissolve.

Causes of Combination and Concentration.—To enter into an exhaustive treatise on the forces that make for combination and concentration of the business units in modern industry is somewhat without the purview of this work whose prime purpose it is to describe the present day types of ownership organization. However, without a brief survey of some of the more important causes lying at the bottom of this phenomenon, the picture would be lacking in completeness. We may summarize them as follows: (1) The economy of large-scale production; (2) the advent of periodic maladjustments in the relation of supply to demand; (3) the tendency for competition to force prices below the cost of production; (4) the immobility of economic capital represented by industrial plants, etc.; and (5) the pouring of surplus investable funds into saturated industries through the activities of professional promoters.

A perfect balance between the factors of supply and demand can scarcely ever exist throughout all fields of industry. It has been the world's experience with the present industrial system that the demand for goods will exceed the supply over a period of years that is characterized as a period of rising prices and that, sooner or later, the supply of goods will exceed the demand, ushering in a period of declining prices. Thus, a period of true normal growth of both demand and supply is indeed a rarity. It exists largely as a theoretical concept. The laws of nature

are not subject to human control, and so long as this is the case, it is extremely difficult for man to make the supply of goods balance his needs. He aggravates the forces behind this lack of balance still more by the methods of production and distribution that he has introduced into his economic life.

The modern technico-mechanical method of production is characterized by its large-scale producing units. Minute division of labor, accompanied by highly specialized machinery, has made the modern industrial enterprise one that can produce profitably only by producing in large masses of like units. The cost of production per unit is lowest when a machine is operated at its maximum rated capacity. This, coupled with the fact that each succeeding stage in the process of manufacture is dependent upon its immediately preceding stage, tends to keep the whole system keyed up to a capacity that will approximate the maximum for the units worked. However, the system is insufficiently elastic to permit of contraction of supply in conformity to a slump in demand. Not only is it difficult in many industries to make a uniform cut of ten per cent in the total finished product, but such a cut involves a relative increase in the cost per unit as prices fall because of the overhead charges for invested capital.

This situation is made clear by assuming that a corporation operates three small steel mills, located respectively in Pittsburg, Chicago and Scranton. Each plant is equipped with two blast furnaces which furnish the raw material for further manufacture. The demand for the products of this concern now falls off uniformly to three quarters of the productive capacity of the plants. The company cannot operate a blast furnace at less than its rated capacity without sustaining an enormous loss, and it continues to operate them as before. The same is true of its converters and open-hearth furnaces. The individual production

centers of its plants are not so rated in their capacity as to make two lines of sequence each performing the same processes as the other. One bessemer converter might be sufficient to meet its requirements in that direction, while three open-hearth furnaces complete the steel making equipment. These can just take care of the full product of the two blast furnaces. Such a plant is obviously not a multiple of like units linked together into two or three complete chains of production centers that can produce the finished product independently of each other. It is itself a single producing unit. Consequently the company will continue to operate it at its full capacity, at which point the cost of production is lowest, until the continued oversupply of steel products has brought prices down so low that it will entail less loss to the company to shut down completely. To reduce its output, the corporation must close one of its plants; for under competitive conditions of production, it cannot operate all three at much less than capacity without increasing its cost of production to the point of destroying its market.

While most of our great fundamental industries are thus confronted with this necessity for capacity production, there are others in which the multiple duplication of mechanical devices, as for example in the cotton textile industry, gives a relatively greater degree of elasticity to the rate of production. In others again, such as the shoe manufacturing industry, there is no direct capital investment for machinery, but merely a fixed charge per pair of shoes; hence, here also the overhead charges do not increase greatly with the reduced output.

In considering the demand side of the equation we must bear in mind first of all that the factor of demand itself is influenced by numerous other factors, such as the capacity for consumption in a given community of a given article at a given price, and what influence an over-pro-

duction exerts upon the demand. None of these factors is stable, neither does any one progress at a uniform pace. Any large, unanticipated increase in a nation's general supply of goods must reflect itself in the form of relatively lower prices, and tends, thus, to increase the general demand for goods. This, however, does not always mean that those entrepreneurs whose enterprise has been blessed with the unexpected increase in quantity of product will receive a greater profit. A bumper grain harvest, or cotton crop, may so reduce the price of these commodities as to prevent any financial benefit from accruing to the farmers and planters who grew it. It may even mean a direct loss to them since the cost of producing it may have exceeded the price that it will bring on the market. Such, for instance, was the condition of the growers of these crops, in 1920, when quantities far in excess of market requirements were produced.

However, such an excess harvest, because it does result in a general lowering of prices in these goods, tends to cause a general speeding up of industries that use them as raw material. It tends to lower the cost of living, to bring down wages and to widen markets. Railroads must be equipped to handle the crops, mills to grind the wheat into flour, and others to work up the cotton into consumable goods. All take on greater activity. In this way the whole industrial organization tends to increase its productive capacity, while new establishments spring up to share in the increased prosperity.

It is at once clear that a series of large harvests, or an excessive demand for goods arising from war or other causes, raises the productive capacity of industry above the normal requirements and draws new competitors into fields that under normal conditions might be considered to be already fully equipped to meet normal demands. Capital is constantly being attracted to industries in which a profit

somewhat above the normal may be obtained. This process continues until the balance between supply and the inflated demand is restored. But sooner or later will come a time when the supply exceeds the requirements of the community. It may be brought about gradually through a falling off in the rate of increase of population or through a gradual depletion of the soil, or suddenly by a series of crop failures, the erection of tariff walls cutting off outside markets, or the like. Industry then comes suddenly to the realization that it is producing goods that it cannot sell, or that it can sell only at a price that is below the cost of production.

It is at this point that the industry in question is faced with the problem of readjusting the factors of supply and demand. It must reduce its rate of production or increase the demand for the product. The latter is ordinarily a slow process that may take a long period of time, and besides it is one over which the industry has little control. Nevertheless, a price reduction would enable the industry to make the existing market as effective as possible. A reduction in price necessitates a reduction in costs. Wages are attacked first, then cost of materials and so on. Those concerns that cannot make these reductions will sooner or later close their plants. Some may be forced into insolvency. But they all remain as potential competitors, because capital once sunk into a specialized plant and equipment cannot again be recovered. Even the insolvent ones retain their potential productive capacity for they are seldom abandoned. They merely undergo a financial reorganization, a change in the form of outstanding securities, and perhaps a change of ownership. They wait only for the demand to pick up when they again enter the field as active competitors, with perhaps a slight advantage over others arising from reduced overhead costs, for their interest requirements may

have been reduced through reorganization. Then as demand begins again to revive, production is soon at its maximum capacity, while new capital is drawn in until competition is more severe than before.

But such lessons do not always go unlearned. Here and there, may arise a far-sighted man who, through his commanding position in the industry, may bring the warring factions together for the mutual benefit of all concerned. An agreement on prices, production or markets may be entered into, or an association for regulation of competition may be formed, or the competing factions may be bound together through ownership ties. This process may continue to the point of monopoly of the industry or it may simply result in reducing the number of establishments to a point where but a few large combinations are in a position to compete in an over-saturated market.

However, it is not always the legitimate entrepreneur who is at the bottom of the combination movement. The country is full of professional promoters, who, with their eyes fixed upon the vast sums of investable funds in banks, insurance companies, trust companies and other financial institutions, fall upon the happy idea that a combination can be formed. The question of economic need or expediency does not concern them. They make their profit by organizing the new enterprise, not by operating it. It is not a difficult matter for them to obtain the necessary finances, for the so-called "private banks" and trust companies are ever ready to enter into underwriting syndicates to finance the new enterprise. They, like the promoter, step in, not as entrepreneurs of the undertaking, but as merchants who sell it money capital in return for its securities, which they then try to sell at a profit to speculators and investors. Whether the economic conditions warrant the new enterprise and what happens to it afterwards does not greatly concern those that have brought it into being.

It is thus seen that there are times during which economic conditions are such as to usher in a period of combination that extends generally throughout the whole industrial fabric, and that these periods are separated by years of commercial and industrial stagnation during which the forces making for combination lie more or less dormant. This is not only true of industry in the United States, but also in all of the great industrial countries of the world. But before entering into a discussion of these periods, it will be necessary to explain the direction in which combination may take place.

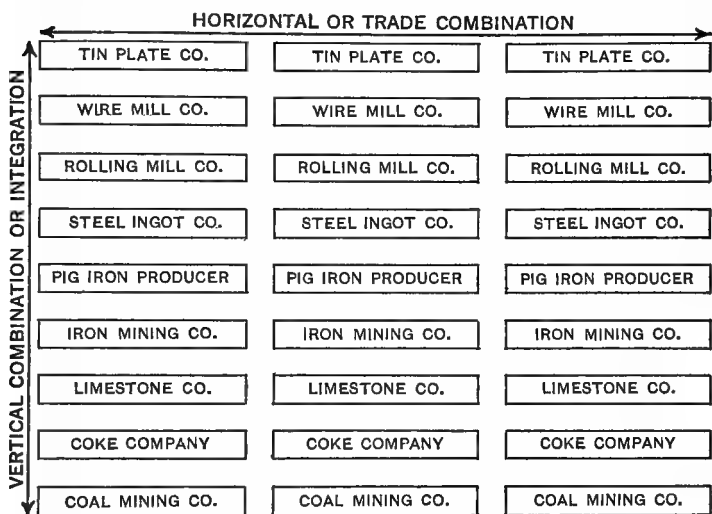
Direction in Which Combination May Take Place.—

Let us assume that each entrepreneurial unit in the steel industry confines its activities entirely to the performance of a single step in the process of manufacture necessary to produce a marketable product that serves as raw material for the units performing the next higher step. We may then sort them out into groups composed of like units and arrange them into horizontal rows. These rows may next be arranged according to the sequence of the stages of manufacture necessary to produce the finished product. By this means, as indicated in the diagram on opposite page, we obtain horizontal rows of like units, and vertical columns of unlike units, that are capable of performing all the steps necessary to produce the finished product.

If now, as a result of economic conditions, it becomes necessary or desirable to combine the units, we may do so in either of two directions, namely, we may combine the like units in the horizontal rows, or the unlike units of the vertical columns. The former is usually known as *horizontal combination* and the latter as *vertical combination* or *integration*.

Horizontal combination aims usually at a control over the product from the standpoint of market conditions prevailing in the industry that it embraces. Such combines

seek ordinarily to control the selling price of the product, to regulate the production in order to prevent an over-supply, to apportion the demand among the units by assigning to each a certain geographical territory or a given per cent of the total estimated production for the year, or to obtain a complete monopoly over the product. Since it depends to a much greater degree upon control over mar-



keting, than over production for its effectiveness, it is frequently called *trade combination*.

In the United States, this form of combination began to gain prominence shortly after the close of the Civil War. From that time on it continued more or less unhampered until the passage of the Interstate Commerce Commission Act, of 1889, and the Sherman Anti-Trust Act, of 1890. Since the passage of these acts it has proceeded at a somewhat lessened pace, but with equally important effect. It manifests itself in several ways, such as the building up of large-scale business units followed by a binding to-

gether of these units through agreements into associations, federations, and holding company organizations. Thus, the census statistics show that in 1860 there were some 2500 business establishments engaged in the manufacture of agricultural implements and by 1910 there remained but 640 whose total output was valued at over \$94,000,000; but 34 of the 640 each valued their annual product at over \$1,000,000 and these accounted for 64.3 per cent of the total product. Establishments engaged in the tanning, curing and finishing of leather numbered about 7600 in 1870, but by 1910 only 919 are reported, but 78 of these accounted for nearly one half of the total product valued at over \$150,000,000. The same condition exists in the case of carpet mills, tobacco manufacturing establishments, smelting and refining of copper and lead, worsted, woolen and felt mills and many other industries. This process may take place very rapidly, as illustrated in the case of the Diamond Match Company which, in 1880, is reported to have bought up some 75 match factories which it thereupon combined into 37, and in 1900 it had reduced these to 16 in number.

There are, however, a few industries that are conspicuous for their resistance against this method of combination. Among these are the cotton textile and the boot and shoe industries. The former is not a fit subject for this type of combination because of the relatively greater degree of elasticity in the adjustment of output to demand and the great range of products that a single mill is capable of producing. In the shoe industry, combination has been confined largely to a monopoly through control of patents covering the important machines used in making shoes, rather than of the makers of the finished product. These patents are held by the United Shoe Machinery Company which leases the machines to shoe factories.

In their looser form or embryonic stage, these combina-

tions manifest themselves as associations based on agreements between the units usually seeking to control prices, accompanied at times with apportionment of the market, pooling of profits and limiting production. Thus, we find in 1901 the American Publishers Association, whose members published about 90 per cent of American books, co-operating with the equally extensive American Booksellers' Association in an attempt to control the resale price of copyrighted books; and later in the drug trade, national organizations of manufacturers, of wholesalers and of retailers coöperating with one another for the same purpose. We find them in the wall paper industry, the lumber industry, oil cloth, powder, tobacco and a great many others. But such associations have almost invariably run counter to the federal and state laws against combinations in restraint of trade. For this and other reasons, there has been a tendency to form horizontal combinations by making use of the holding company.

Some of the largest of our horizontal, holding-company combinations were formed during the great combination or "trust" period, 1897 to 1902. Among these may be mentioned the telephone combination effected through the American Telephone and Telegraph Company in 1900, that now owns or controls about 70 per cent of all the telephone stations in the country, which in 1919 numbered over 12 million. The famous Northern Securities Company, through which the control over the Great Northern Railway Company, the Northern Pacific Railway Company and the Chicago Burlington and Quincy Railroad Company was unified, was formed in 1901. The International Mercantile Marine Company, combining some eight or nine great trans-Atlantic steamship lines, also was formed at about this time. Since 1910, the same phenomenon has made its appearance among trading establishments. In the drug business we now find the American Druggists' Syndicate

and the United Drug Company, which, however, are to some extent integrations. Similarly, we have the United Retail Stores Corporation organized in 1919, the Associated Dry Goods Corporation, 1916, and the Mercantile Stores Company, Inc., 1919, together with a host of others, the list of which is growing rapidly.

Vertical combination, or integration, seeks to gain a market advantage by establishing a control or ownership interest over the establishments that perform the greater part of the stages of production preceding and succeeding the one that forms the chief operation of the key unit. Thus, the pig iron producer in the diagram may extend his operations forward in the direction of the finished product or may reach backward producing his own raw materials. When the process has been carried to completion the combination is no longer dependent upon independent producers of raw materials and half-finished products, and it will also have reduced the effect that fluctuating markets will have upon it, for it need not worry about market conditions for steel ingots or rolling mill products as such. It, of course, also tends to reduce its costs of production to a minimum and to stabilize them in so much as it no longer need pay a profit to intermediate manufacturers and producers of raw materials. But since integration demands the closest coöperation between the several units that perform the different stages of manufacture leading up to the final stage involved, it necessitates a much more comprehensive and durable control than might suffice to bind a horizontal combination together. For this reason vertical combinations are usually built up through the acquisition of an ownership interest in the several units that are to be combined.

In the iron and steel industry one of the chief forces back of the integration movement seems to have been the change in demand from iron to steel. The process has

been well described by the president of the Republic Iron and Steel Company in testimony taken in a suit for the dissolution of the United States Steel Corporation. This account is as follows: "We have practically eliminated all our scattered iron mills, have concentrated them in the operation at a few points of production. So, today we produce practically but little iron and are manufacturing about 1,000,000 tons of steel per annum. This is what we call an integrating process; that was part of it, the addition of the mineral and coke and blast furnaces, and balancing up operations generally completing the integrating process. . . . This integrating process that I speak of attended our development of the steel end of our business. We did not need it so much when we were simply manufacturing iron. It was done for economic and trade reasons on account of the increased demand for steel and the decreased demand for iron." ¹

The great period of integration in American industry was ushered in about 1897. Business had just emerged from a long period of depression which began with the financial collapse of 1893. Several events occurred and certain circumstances were present that gave the integration movement the initial impetus that it required to set it in motion. The first of these events was the passage by the legislature of the state of New Jersey of an act giving to all corporations chartered by that state the power to hold the securities of other New Jersey and foreign corporations, and to exercise with respect thereto all the rights and privileges of natural security-holders. Thus, a new form of organization, most admirably adapted to combination purposes, was provided. The second event was the wonderful American wheat crop of 1897 coupled with a general failure of crops in Europe. While Europe had a shortage of from 300 to 400 million bushels, we had

¹ *United States v. United States Steel Corporation*, 223 Fed. 55.

a surplus of over 100 million bushels. This condition resulted in a real, thoroughgoing industrial revival. Competition was soon again at its height and showed all indications of the approach of a general battle of giant establishments for the elimination of the weaker and the survival of the fittest. In the third place, there was an equally rapid expansion of our foreign trade. During the depression the American people had been economizing and by 1897 vast quantities of manufactured products had accumulated. The manufacturers feared that these would glut the market and decided to get rid of them. Germany and Great Britain had recovered from the depression somewhat earlier than the United States, and had begun a period of rapid colonial development. The American goods were rushed into these colonies, into Russian and European markets, even to Germany and England, where they were sold at much less than the cost of their manufacture. As a result, our export trade in manufactures jumped by hundreds of millions of dollars. In addition to these factors there were on hand in the American banks, insurance and trust companies vast accumulations of investable funds representing the savings of the people. The financiers were ready to put these funds to work. Opportunity beckoned and the industrial and professional promoter answered the call. The period of combination that followed, with the possible exception of that which occurred in Germany following the close of the World War, has had no parallel in history.

During the first few years of the period, the combinations, or "trusts" as they have been popularly called, were largely along horizontal lines. Railways were consolidated into a few great systems, ocean and coastwise steamship combinations were formed and the number of establishments in several stages of production in the iron and steel industry was reduced. This lasted until 1901, when

a general scramble to integrate was ushered in through the formation of the United States Steel Corporation. But there was only so much money with which to do the work. The movement came to a stop in 1902 as suddenly as it had begun. Not only had the supply of investable capital become exhausted, but the general public had lost confidence. Professional promoters, impelled by speculative profits, had poured so much "water" into many of these combinations that they soon failed, causing a loss of millions to gullible investors who had relied upon false prospectuses. Speculation overdid itself and hundreds of millions in the stocks of these great combinations were batted back and forth like shuttlecocks between brokers and speculators on the exchanges. There they remained for a period of years until the time when the public could be convinced that they were legitimate and reasonably safe investments. Even today the public remains unconvinced of the soundness of many of them.

During the period from 1902 through the depression following the financial panic of 1907, the forces making for combination were noticeably dormant. But with the revival of business in 1909, combinations began again to be formed, particularly in the newer industries, such as automobile manufacture and its related undertakings. The outbreak of the World War in the summer of 1914 checked it temporarily, only to give it a new impetus during 1915, 1916 and the first few months of 1917. These years witnessed many combinations, both along horizontal and vertical lines, among munition establishments, shipping and foreign trade concerns and retail trade companies, while the great steel companies erected shipbuilding plants and carried their integration a few steps forward. This short period was again brought to a close with the advent of the business depression that began in 1919.

In Europe, the progress of combination had a similar

history but was by no means uniform in the several countries. In England, it can be said to have begun shortly after the passage of the Limited Companies Act, of 1862, and to have reached the climax during the decade from 1880 to 1890. The English business combination is neither horizontal nor vertical, but rather financial in character, being effected through what is called the "investment company" described in a later chapter. The reasons for the deflection of the movement along this peculiar tangent are perhaps to be found in the laws against organizations and combinations in restraint of trade, in the conception based upon economic teachings, that free competition is the natural order of business which may best be conducted as individual enterprise, and in the policy of free trade that makes it almost impossible to have higher prices within the country than exist without. But despite these obstacles, a few combinations have been formed, particularly in the South African Mining Industry and in the manufacture of soap. Lever Brothers, Ltd., have practically a monopoly of the latter industry. These, however, are but exceptions rather than the rule.

In Germany, the combination movement appears to have begun in earnest during the decade preceding the year 1890. Instead of being legally suppressed, it was encouraged. As a result of this attitude it naturally followed the horizontal lines which did not generally affect the ownership interest, but brought into being great syndicates to control the distribution of the product. These syndicates are called "kartells." The exacting requirements of the law concerning corporate promotions and capitalization appear to have interfered somewhat with the process of integration, and to have brought about a condition of financial combination centering about the great banks, while large numbers of so-called "finance companies" tie the establishments of each industry together into a vast, more or less unified

network dominated by a central concern and its affiliated banking interests. However, since the close of the war the weakness of horizontal combination has become apparent. It is too susceptible to control by labor organizations and presents too good a target for the application of state control or the institution of state ownership. Thus, under the leadership of such men as Hugo Stinnes, August Thyssen, the Krupp group and others, a period of integration has been ushered in that has been surpassed only by the great American trust period. What the final result of this movement will be, it is difficult to foretell.

In Belgium, combinations have followed the lead of Germany, since its industrial system corresponds most closely to that of its larger neighbor. France, which is not an industrial country in the modern sense of the term but rather has contented itself with putting its savings into foreign investments, seems in a large measure to have followed the English example. Switzerland with its cosmopolitan population, seems to have borrowed not only from its several European neighbors but also from the United States. Combinations in other European countries have, for the most part, emanated from one or the other of the greater industrial nations and cannot be said to have been influenced greatly by any native or local considerations.

Classification of Combination Organizations.— Enough has already been said to indicate that there are several types of organizations that may be employed for purposes of combining entrepreneurial units. These may be divided into two broad groups, namely, (1) those that do not ordinarily involve a claim on the capital of the units involved and (2) those that are instituted through the ownership right. In each group there are several classes as shown by the following outline:

A. Combinations ordinarily not involving ownership rights:

- (1) *Associations* formed by means of agreements between units that retain their autonomy, but pledge themselves to coöperate in carrying out the aims and purposes of the organization. They are commonly known as "business men's associations."
- (2) *Factors' Agreements*, whereby producers and distributors seek to exercise a control over the product with respect to price, conditions of sale, etc., while it is being distributed by independent businesses. The most common types are "price control agreements," "tying contracts," and the like.
- (3) *Federations* created by agreements between combining units that retain considerable autonomy, but delegate to a central body in which they are usually represented the power to control certain phases of their business. There is usually documentary evidence of their existence. The most important types are known as "pools," "kartells" and "syndicates."

B. Combinations involving ownership rights:

- (4) *Securities-combinations* formed through the acquisition by a person or a business organization of the securities issued by other ownership organizations. They may or may not be for the purpose of control. Where control is the aim it is exercised through application of the rights resting in the security-holder. The holding corporation, the combination trust and, more rarely, the joint stock company are employed for this purpose. The various means of utilizing this method of combination will be described under the title of *securities-substitution companies*. These constitute the most characteristic ownership feature of our modern business organization.

- (5) *Fusions* arising out of a unification of the assets, liabilities and general business of several units, leaving but a single unit. They include "mergers" and "amalgamations."²

This classification is based upon the extent to which the independent action and existence of the individual ownership unit is compromised, limited or controlled. There is no clear-cut line of demarcation dividing the several types. A single combination may employ one or more of them in its make-up. While pure forms, that are representative of the several classes, are very common, they are perhaps no more so than the hybrid types. For this reason it is deemed advisable to describe and treat them in groups, namely; (1) those that ordinarily do not involve ownership rights and (2) those that involve such rights directly. And while it may be objected that the former class is not a proper subject for a work of this kind, because those types of combinations introduce no new principle into the ownership organization; yet it must be conceded that without some understanding of these forms of combination, it would be difficult to portray the ownership organizations of today to a degree even approaching completeness.

² Combinations formed under methods 4 and 5 are frequently called consolidations. Under this heading the several types of fusions were fully explained in Chapter XI.

CHAPTER XIV

COMBINATIONS ORDINARILY NOT BASED ON OWNERSHIP RIGHTS

A. ASSOCIATIONS AS BUSINESS COMBINATIONS

ASSOCIATION is a human instinct that is quite as prevalent among business entrepreneurs as in any other class of society. It furnishes that element of cohesion essential to the existence of organized civilized society; and is especially developed in the field of business enterprise where it fosters that stability and progress so necessary for the fullest development of business opportunity. No class of persons knows better than the business man the value of association, and no other class has utilized it to such great advantage. He knows full well the truth of the old adage "in union there is strength," and proceeds to organize his general and specialized types of associations. This he has done for centuries and is still doing, on a grander scale than ever before.

Back in the middle ages the chaotic and unstable political conditions led to the development and organization of the Gild Merchant in the incorporated towns and boroughs where business first began to rear its infant head. These organizations had for their purpose, among other things, the adoption of uniform trade practices, weights and measures and the like; but they soon became part and parcel of the town government and lost their business character. Trade Gilds made up of all masters (entrepreneurs) engaged in a given trade within the community, took their place as business men's associations. The weavers,

butchers, bakers, fullers, wheelwrights, etc., each had their own trade gild seeking to control conditions, production, prices and the like. At a later date, when foreign commerce slowly made its way through pirate-infested seas to more or less hostile foreign shores, there arose in England the Merchants of the Staple and the Merchant Adventurers; associations that, with the aid of the king, sought to stabilize, foster and protect this new born trade, that they and their communities might benefit thereby. In Northern Europe, particularly in Germany, there grew up in the same way the Hanseatic League. This League, because of the impotency of the governments of the numerous small states in which its members carried on their commercial enterprises, was soon forced to take upon itself also political and governmental duties. And while it was primarily a commercial organization, it was more powerful than many monarchs of its day.

From these early beginnings the business men's association has come down to us in the form of chambers of commerce, boards of trade, commercial associations and trade and industrial associations. Shorn of its active governmental powers by relatively strong and stable governments, it contents itself largely with building up and developing its community, trade or industry, with shaping commercial and labor policies, tax programs and the like. It is ever active and watchful of legislation affecting business. There is scarcely a municipal, state or national government where its lobbyists are not constantly at work. And even today, it occasionally rises up in its might to oust from office a political party whose policies it does not like, as is well shown by the part played by such associations in breaking the hold of the Non-Partisan League in North Dakota.

These present day business men's associations may be divided into three broad classes, namely; (1) those that are general and essentially territorial in character; (2) those

that include only business units engaged in a particular trade or industry; and (3) those that have some special purpose in view.

General Commercial Associations. — Among the general business associations of the United States, the Chamber of Commerce of the state of New York is said to be the oldest, dating back to 1768. The purpose of the organization is stated in the resolution creating it as follows: "mercantile societies have been found very useful in trading cities for promoting and encouraging commerce, supporting industry, adjusting disputes relative to trade and navigation, and procuring such laws and regulations as may be found necessary for the benefit of trade in general. . . ." It has since widened its activities and gives attention to all matters of local, state and national concern. In most of our states there now are similar general associations.

The merchants and business men of our larger cities also have formed general associations patterned after the state associations, but local in character. New York City has its Merchants Association; Chicago and New Orleans, their Associations of Commerce; Detroit, its Board of Commerce; and among others Boston, Cincinnati Cleveland, Los Angeles, Philadelphia, Portland, San Francisco and St. Louis, their chambers of commerce. A great many smaller cities and towns also have their own local associations patterned after these.

Since about 1900 these state and local associations have made frequent attempts to organize a national chamber of commerce. The first attempts met with little success. But in 1912, Secretary Nagel of the Department of Commerce and Labor, at the suggestion of President Taft called together representatives of state and local associations, and out of this meeting sprang the Chamber of Commerce of the United States of America. The by-laws of this or-

ganization state its aims to be: "To secure cooperative action in advancing the common purposes of its members, uniformity and equality in business usages and laws, and proper consideration and concentration of opinion upon questions affecting financial, commercial, civic and industrial interests of the country at large." In the following year it was reported to have had a membership consisting of over 600 commercial organizations and over 1,700 individuals. The vote of the members on all matters is usually obtained by mail.

Trade and Industrial Associations.—However, these general associations do not afford the business man all the advantages that he seeks. Each trade and industry has its own special problems that may best be dealt with through special associations. Local butchers, grocers, druggists, bankers, etc., frequently form their own associations, as also do manufacturers of steel, automobiles and other commodities. Thus, we find in this country the Philadelphia Association of Retail Druggists, the California Fruit Growers' Association, the New York Tow Boat Exchange, the Michigan Salt Association, the Southern Pine Association and hosts of others. But in many trades and industries there also are national or regional combinations, such as the National Automobile Chamber of Commerce, the American Iron and Steel Institute, National Association of Window Glass Manufacturers, American Association of Button Manufacturers, National Wholesale Druggists' Association, National Association of Retail Druggists and the Copper Producers' Association.

Special Purpose Associations.—It is often found desirable to organize associations for special purposes. In this case the character of the membership resembles that of the general associations, but is more restricted. The most prominent representatives of this class are the numerous foreign trade associations that have shown an astonishing

development since the close of the World War. They are represented by such organizations as the American Manufacturers Export Association, the Philadelphia Commercial Museum, the Exporters' and Importers' Association, the Export and Import Board of Trade of Baltimore, the Foreign Trade Club of San Francisco and the National Foreign Trade Council of New York. Among them may also be included the numerous American chambers of commerce established in foreign countries. They are to be found in such cities as London, Berlin, Paris, Milan, Naples, Brussels, Shanghai, Mexico City and many others. Their chief purpose is to promote friendly foreign trade relations, to develop foreign markets and to suppress questionable trade practices.

Business Associations in Other Countries.—Prior to 1914, business associations of the type under consideration, had perhaps attained a greater development in Germany than in any other country. However, European business establishments emerged from the late war in a much weakened condition which placed them temporarily at a disadvantage in competing against the strong American firms that had sprung up. As a result a general reorganization involving all forms of combination set in, and in most of the industrial countries of Europe strong national associations of business men were formed. In England arose, in 1916, the Federation of British Industries, which in four years enrolled no less than 1,300 members including some 200 trade associations. It is reported to be in direct or indirect touch with over 20,000 British manufacturers, covering every industry in the country. Its governing board consists of 211 members made up of the leading men in all industries. In Germany, in 1919, the Reichsverband der Deutschen Industrie was formed by consolidating two prior existing organizations, namely, the Zentral Verbund der Deutschen Industriellen and the Bund der Industriellen.

It includes in its membership several hundred associations representing about 50,000 firms, either directly or through affiliated associations. Its purpose is stated to be to advise concerning the fulfillment of the economic provisions of the peace treaty, to study and recommend tax policies and to aid in promoting sound economic policies. In France, in 1915, L'Association National d'Expansion Economique was formed under the auspices of the Paris Chamber of Commerce. It comprises most of the important manufacturers, trade associations, insurance, banking, shipping and railway interests of France.

One of the latest developments in this type of combination organization is the International Chamber of Commerce. This association was formed in 1920 with its official seat at Paris. It is intended to serve as a clearing house for international business information; to consider laws affecting commerce; to suggest changes in the enactment of new measures that will improve conditions; to affect reforms on its own initiative in business customs and practices to bring better results; and to gather and distribute information necessary to the better conduct of commerce and to suggest improvements of the existing system to governments.

Tendency to Federate for Purpose of Control. — There has always been a marked tendency among the trade and industrial associations to inaugurate schemes for the control of prices, production and distribution of the commodities in which their members deal. To accomplish this end some have frequently availed themselves of the use of factor's agreements, while others have strengthened their organization so that this partook more of the character of a federation, in so far as it sought to gain power of control over certain aspects of its members' business. These practices have caused many of them to be called before the courts charged with violating the provisions of the federal Anti-Trust Laws and similar state statutes.

B. FACTORS' AGREEMENTS AS INSTRUMENTS OF COMBINATION

Factors' agreements may be defined as contractual arrangements whereby one of the contracting parties secures a limited control over the freedom of action of the other in business matters. Usually, they aim to diminish, moderate or prevent competition in the sellers' line of commodities. The provisions of the Sherman Act, declaring agreements in restraint of trade to be unlawful, are aimed at them, and the Clayton Act of 1914 gives them even greater attention under provisions against the use of unfair methods of competition.

A careful study of agreements of this kind brought to light through court proceedings, shows that their variety is very great.¹ However, for sake of convenience they may readily be classified into three kinds, namely; (1) conditional requirements; (2) exclusive arrangements; and (3) preferential arrangements with or without rebates.

Conditional Requirements.—This type of factors' agreement is frequently employed by manufacturers or dealers who have a more or less complete control over certain kinds of commodities, to bind the purchaser of these commodities to buy only from the seller certain other commodities over which the latter has no such control. Thus, manufacturers of patented articles and machines often insert in their contract of sale that the buyer, or dealer shall purchase certain non-patented articles or those on which the patent monopoly has expired, only from the seller of the patented article. Others again require the buyer to handle new lines of commodities as a condition of continuing to handle old lines, or to purchase certain commodities as a condition of the purchase of others.

¹ Specimens of such agreements may be found in Dr. W. H. S. Stevens' *Industrial Combinations and Trusts*. See also *Unfair Competition* by the same author.

For example, between 1906 and 1909 the General Electric Company secured from the German owners the patents and applications covering tungsten and tantalum filament lamps. The demand for electric lamps in this country was such that dealers were more or less obliged to handle not only the old carbon filament lamp but also the two newer types above mentioned. Patents covering the carbon lamps had expired, in 1894, and many manufacturers had lamps of this kind on the market. Among them was the General Electric Company. This company set about securing all of the carbon lamp business. Since the newer types could be bought only from it, it stipulated in its contracts of sale that purchasers of tungsten and tantalum lamps must also buy from it all of their carbon filament lamps. The United States Supreme Court, however, declared these contracts to be an unlawful restraint of trade.

The "full-line forcing" — a practice of requiring dealers to order new lines of products as a condition to retaining the agency for some brand of the company's harvesting machines — employed by the International Harvester Company is another such practice discountenanced by the courts. The United Shoe Machinery Company, the Motion Picture Patents Company and the American Coal Products Company also made extensive use of factors' agreements of this type.

Exclusive Arrangements. — Professor W. H. S. Stevens defines exclusive arrangements as "arrangements which require that certain dealings or transactions shall be confined exclusively to a specified organization or organizations."² They are frequently included in contracts involving conditional requirements.

Three types of exclusive arrangements have been commonly used, namely; those that require (1) exclusive use; (2) exclusive sale; and (3) exclusive purchase of the com-

² W. H. S. Stevens, *Unfair Competition*, p. 77.

modity in question. For example, the United Shoe Machinery Company stipulated in its contracts, that the lessors of certain of its patented machines should use them only in connection with nails and other commodities sold by that company for the manufacture of boots, shoes and footwear. The American Tobacco Company provided in its contracts with dealers, that the exclusive sale by them of its products would entitle the dealers to a rebate of 7 per cent, whereas otherwise the rebate would be but 2 per cent. But in many cases they completely cut off the supply of their cigarettes to dealers who did not handle the American Tobacco Company's products exclusively. The National Wall Paper Company and the Eastman Kodak Company usually stipulated in their contracts with dealers, that the latter bound themselves to purchase only the product of the respective companies.

Preferential Arrangements. — Provisions in contracts of sale, whereby dealers or users of the commodity are given rebates and other special reductions in the purchase price of the commodity for the purpose of suppressing competition, have been very common. These are now usually called preferential arrangements. The records of the federal courts give many examples where they were used by railroads, steamship companies and industrials. They helped build up the Standard Oil and the tobacco monopolies and numerous others. In the case of the Standard Oil Trust they took the form of rebates given to that combine by railroads on the freight charges for oil transported, an advantage that other oil companies did not enjoy. The American Tobacco Company used a similar practice in connection with exclusive arrangements to build up a semi-independent distributive organization over which it might exercise control.

All of these three types of factors' agreements serve at their best as a very weak form of combination, since

there is in most cases no legal means of forcing compliance with them. While they still crop out occasionally, they are nevertheless becoming less common, and are gradually giving way to ownership combinations built up on the integration principle.

C. FEDERATIONS

The federation, as before stated, differs from the association and the factors' agreement in that it provides in the agreement creating it for a central body which shall exercise some measure of control over the business of the combining units. This power of control usually hinges upon one or more of three factors, namely; (1) the supply of the commodity in question; (2) the market or demand for it; and (3) the price at which it is to be sold. It may or may not be accompanied by penalties to be imposed upon recalcitrant members. The chief aim and purpose of these combinations is the suppression of competition. In the United States they are called *pools*, while in Europe the name *kartell*, or *syndicate* is applied to them.

Federations ordinarily are combinations of the horizontal type, including in their membership few or many establishments in like stages of production or distribution. Occasionally, however, we do find federations of manufacturers, wholesalers and retailers, respectively, bound together through factors' agreements into a gigantic combination that has a complete control of the entire trade in a given type of commodity. As a matter of fact, there seems to be a marked tendency on the part of these combinations to extend their control as far as possible. In the United States, this soon brings them before the courts as violators of the anti-trust laws. In Europe, on the other hand, they enjoy quite generally the sanction of the law, and are frequently even fostered and encouraged by the governments.

The American Pools. — Pools became prominent in the

United States during the decade following the year 1870. At first they were successfully used by the railroad companies, who employed all three of the basic elements above mentioned in organizing them. Somewhat later, the industrial and trade branches of business took up this form of organization. It was early recognized that they not only sought to restrict competition, but that they actually did so. Thus, when the Interstate Commerce Commission Act (1887) and the Sherman Anti-Trust Act (1890) were passed, they included provisions seeking to suppress pools that substantially reduced competition and unduly restrained trade between the states or with foreign nations. This resulted in the development of new forms that it was hoped would, at least technically, be outside the pale of these laws. Nevertheless, it remains a fact that they seek to suppress competition; and one need not look far in the annals of court decisions under our anti-trust legislation to find many of them that have been adjudged to violate these laws.

A careful study of the documentary evidence contained in these decisions, and of specimens of pool agreements disclosed in reports of Congressional and other committees, enables us to classify American pools according to the means used to accomplish the end in view. From this standpoint we recognize a number of distinct methods that have been used in organizing pools. However, several of these may be employed in a single pool. They are as follows:

1. Percentage Division of Business. — The total business done by all those in the pool is allotted to the various members usually in proportion to their productive capacity, and these agree to stay within their limits or pay a penalty to the pool on exceeding their percentage. Bonuses are commonly paid to those who produce less than their allotted percentage. The percentage contributed by each

firm to the total production of the preceding year is taken as a basis. The scheme has no legal sanction, and is not enforceable at law. Nevertheless, pools of this type have been fairly common in the steel industry, for steel rails, structural steel, wire nails, etc., in the hardware business in the manufacture of saws, screws, shovels, door hangers, etc., in the distilling and other industries. The tendency of the stronger firms to crowd out the weaker ones who have no protection at law under the agreement, tends to cause frequent disruptions of these pools.

An excellent example of this type is the Structural Steel Association of 1897.³ There were ten members in this association, each of whom was permitted to take up to a certain per cent of the total monthly sales of structural steel. The apportionment of business in percentage was as follows:

Carnegie Steel Co. (Ltd.)	49 $\frac{3}{8}$
Jones & Laughlin (Ltd.)	12 $\frac{7}{8}$
A & P. Roberts Co.	11 $\frac{1}{2}$
Passaic Rolling Mills Co.	6
Phoenix Iron Co.	5
Cambria Iron Co.	5
Universal Construction Co.	4 $\frac{1}{4}$
Pottsville Iron & Steel Co.	3
Cleveland Rolling Mill Co.	3

In addition, it was provided that the New Jersey Steel & Iron Company should receive \$5,000 per year to remain inoperative in the manufacture of structural steel. Monthly statements were to be rendered to the association's "commissioner" who was to assess members one-half a cent per pound for excess sold and to pay a bonus of a like amount to those who sold less than their quota.

The agreements of the "Steel Rail Pool," of 1887, and of the Tin Plate Association, of 1900, contained similar provisions.⁴

³ For a copy of the agreement see Stevens, *Industrial Combinations and Trusts*, pp. 211-219.

⁴ *Ibid.* pp. 69-71 and 219-225 respectively.

The Brewers' Association, embracing five brewing companies of the city of Washington, provided in its agreement not only for an apportionment of the business, but coupled this with a price-fixing scheme and a prohibition against any customer of a member selling to the customers of another.⁵

2. Curtailment of Output. — These pools seek to reduce competition by curtailing the output, either uniformly or otherwise, of the several members. Thus, in 1881, when the western distillers found that the prices they were getting for their product were really below the cost of production, they decided to limit the quantity of whiskey produced. They formed the "Western Export Association," the officers of which were authorized to levy a monthly assessment on each distiller running his plant. This assessment was to be proportionate to the amount of grain used in the manufacture of spirits, and was to be used to facilitate the exportation of the surplus product. The pool broke up the following year because some members failed to pay their assessments, but it was reconstituted a few months later. From 1883 until 1887 the pool continued for a year at a time, with suspensions as often as once a year. Most frequently it provided for limiting the output of the distilleries. Thus, in 1884, it was stipulated that "only 28 per cent of the full capacity shall be operated, and no stocking up beyond this amount allowed under any circumstances." In 1887, it was definitely supplanted by a trust form of organization.⁶ Another excellent example is the Washington Red-Cedar Shingle Association which combined this feature with regulation of prices. It was formed in 1889, and was empowered to issue from time to time a minimum price below which all members agreed not to sell

⁵ *Leonard v. Abner-Drury Brewing Co.*, 25 Appeal (D. C.) 161.

⁶ An excellent description of this pool and the trust that supplanted it will be found in Ripley's *Trusts, Pools and Corporations*.

shingles to dealers and wholesalers, to establish a system of prices at which shingles must be sold to retail dealers, and to order the closing down of all mills, and to take other necessary steps to curtail the output of Washington red-cedar shingles when this appeared to be necessary.⁷

On the whole, this type of pool is too simple. It is unenforceable at law and the larger members tend to exceed their allotment of production.

3. Territorial Division of Market. — By this method the territorial market supplied by the members of the pool is broken up, and a part allocated to each member. Thus, the "Fundamental Agreement" of the American powder manufacturers (1889) provided not only for a division of territory among the members, but also for yearly allotments of the number of kegs of each variety of powder that each concern should be permitted to make. The agreement was made enforceable through a "Board of Trade." In 1897, these American powder manufacturers entered into a similar pool with the Vereinigte Köln-Rottweiler Pulverfabriken, of Germany, and the Nobel Dynamite Trust, of London, whereby the three divided the world's market area into exclusive territories.⁸ In 1902, two similar international agreements were entered into between six American tobacco companies and the Imperial Tobacco Company of Great Britain whereby the United States, its possessions and Cuba became the exclusive market of the American companies, while the United Kingdom fell to the Imperial Company, and the rest of the world was to be supplied by the British-American Tobacco Company which was controlled by the contracting parties.⁹ A similar, but much more complicated division of market was provided for in the agreement creating the famous Addystone Pipe Pool. The United Coal Tar Refining

⁷ *Gibbs v. McNeeley et al.*, 118 Fed. 120.

⁸ These agreements have been published in Stevens, *Industrial Combinations and Trusts*, pp. 176-183 and 195-205.

⁹ *Ibid.* pp. 161-176.

Company, the American express companies, and the railroads did the same thing. It is also a common practice among the European kartells and syndicates.

4. Centralized or Joint Sales Plan.— Under this plan the combining concerns agree to form an association or company which shall have the exclusive right to sell all, or at least a large part, of their total product. In most cases the central organization is an incorporated company. They are common in the marketing of fruit, tobacco and produce, coal and metals, and are also used to secure greater competitive power when selling in foreign markets.

One of the earliest of this type of pool was the Michigan Salt Association, organized by the salt producers of the Saginaw Bay District of Michigan, in 1876 for a term of five years and renewed for a like term in 1881. It placed no restriction, whatever, upon the quantity of salt produced, but provided that "each and every contractor shall manufacture salt for this association on the terms and conditions as follows: That he will make salt solely on the association's account, of the best quality of the kind manufactured by him, according to the conditions of his lease." Salt might, however, be manufactured for other than association account by paying ten cents per barrel to the association. In this way it succeeded in preventing competition among the Michigan manufacturers and in stabilizing prices. In 1899, it became an easy victim of promoters who took its members into the National Salt Company of New Jersey. In 1901, the International Salt Company was formed to combine the National and other American and foreign companies; but it was so highly over-capitalized that it became insolvent in 1902. Its great weakness lay in the fact that it could not successfully keep down competition. A similar pool was the Naval Stores Pool with headquarters at Savannah, Georgia.¹⁰

¹⁰ The former organization is well described in Ripley's *Trusts, Pools and Corporations* while the agreement for the latter may be found in Stevens, *Industrial Combinations and Trusts*.

In 1908, the tobacco growers of the Burley District of Kentucky found it necessary to protect themselves against the centralized purchasing methods employed by the American Tobacco Company. They formed the Burley Tobacco Growers' Association through which the several hundred members were enabled to confront the single purchasing agent of the Tobacco Company with a single sales agent. The association gained considerable notoriety because of its practice of employing "night riders" to lay waste the crops of such farmers as did not join its ranks. In 1920, it refused to sell its tobacco at the prices offered for it. Similar organizations are the California Fruit Growers' Association and the Raisin Growers' Association of California.

Under the Webb Act, passed by Congress in 1918, legal sanction was given to combinations of corporations engaged solely in "trade or commerce in goods, wares or merchandise exported, or in the course of being exported from the United States or any territory thereof to any foreign nation." Within a few years, more than a hundred such organizations were formed. They vary in form from loose combinations to well organized corporations. An example of the former type is the Textile Alliance Export Association. Any member of the American Association of Woolen and Worsted Manufacturers, the National Association of Woolen Manufacturers, the National Council of American Cotton Manufacturers and the Association of Cotton Textile Manufacturers may become a member of the Export Association. Membership is dependent upon the ownership of at least 50 shares of the 7 per cent cumulative non-voting stock and carries with it the privilege of having a full line of goods carried by the association. Control is vested in the four associations through common stock of no named par value issued to them at a nominal price.

An example of the second class is the Consolidated Steel

Corporation formed by ten American steel companies, excluding the United States Steel Corporation which has its own export company. The Consolidated's capital is \$10,000,000 which is issued to members in proportion to their output for export through it. The stock allotments are held in trust by a board of trustees that nominates the list from which the board of directors is chosen by a majority of the stock interests. The stock allotments are readjusted annually on the basis of exportations for the year.

5. Central Purchase of Total Supply for Resale.—

There are several varieties of this type of pool; first, those that are organized by fabricators for the purchase of their raw materials; second, those organized by merchants for the joint purchase of merchandise for re-sale, and third, the so-called "valorization" arrangements.

Thus, in a case brought against the National Window Glass Jobbers' Association, it was shown that this association was a corporation formed by 75 per cent of the window glass jobbers and dealers in the United States, and that they controlled it through stock ownership. This so-called "association" then contracted with the American Window Glass Company to take a large part of the latter's product, and to sell the glass at predetermined prices through its own stockholders. The parties to these agreements pledged themselves to buy from others only at much lower prices than they paid among themselves and to sell to others only at considerably higher prices.¹¹

Numerous attempts have been made to organize pools of this type to handle the total supply of raw material of a given kind such as cotton, copper and coffee. Unless they provide at the same time for control over the supply of such products, they invariably fail. This arises from

¹¹ *Wheeler-Stengel Co. v. National Window Glass Jobbers' Assn.* (1907), 152 Fed. 864.

the fact that as the outside supply becomes scarce the price will rise, and the inducement to increase production will be greater. Such was the experience of John Hays Hammond when he attempted to corner the cotton supply, and also of the French Copper Syndicate which carried several banks with it when it collapsed. The Brazilian Government's coffee valorization plan met with little better success for similar reasons. In 1906 and 1907 over-production of this crop was making itself felt. Ruin faced the industry. The states of São Paulo, Minas Geraes and Rio de Janeiro then agreed to purchase and hold for better prices enough coffee to keep out of the market all but a quantity sufficient to supply the world demand. Subsequently two of the states withdrew leaving São Paulo to handle the situation alone. This state then borrowed \$88,400,000 with which it purchased over eight million bags of coffee, but even the withdrawal of this amount did not raise the price, and with a new crop maturing the state faced bankruptcy. It eventually succeeded in raising sufficient money through foreign loans to tide it over but was forced to abandon the valorization plan. A factor contributing to the collapse was the decision by the United States courts declaring this to be a monopoly in restraint of trade, thus interfering with its operations in the American market.

6. Price Fixing Pools.—This type of pool is quite common. One of their outstanding characteristics is the extensiveness of these organizations. It is this feature that frequently brings them before the courts as violators of the anti-trust acts, and that has resulted in many a court decision declaring them to be unlawful combinations. One of the most extensive of this type was the Proprietary Drug Pool, brought to light in 1906 in a suit before the United States Circuit Court for the Eastern District of Pennsylvania.¹² It involved all of the members of (1)

¹² *Loder v. Jayne et al.*, 142 Fed. 1010.

the Proprietary Association of America composed of 90 per cent of all manufacturers and proprietors of patent and proprietary medicines within the United States; (2) the National Wholesale Druggists' Association, an unincorporated association composed of about 95 per cent of the wholesale druggists of this country; and (3) the National Association of Retail Druggists, an unincorporated association, with headquarters at Chicago, composed of local associations of retail druggists embracing about 90 per cent of those to be found in the cities and towns of the United States. The operations of this series of combinations united in the form of a pool are succinctly described by the court as follows:

"The burden of proving the existence of this agreement, contract, combination, and conspiracy, and that the defendants were engaged and took part in it, was upon the plaintiff, and for that purpose evidence, which was uncontradicted, was offered to prove that the National Association of Retail Druggists had its central office in Chicago, and received financial support from all the other associations and many of the members belonging to them; that from this central point organizers were sent out for the purpose of bringing the local retail dealers into associations, and, as a result, Philadelphia retailers were organized into an incorporated association known as the Philadelphia Association of Retail Druggists. In accordance with the plans suggested by the organizers sent from Chicago, the Philadelphia retail druggists working with the organizers secured a consensus of opinion of the retailers here from which they fixed the minimum rate at which drugs should be sold at retail by the retail druggists in Philadelphia and vicinity. All the retail dealers were then notified of this minimum rate and in case the retailer cut below the price so fixed his name with this information, was sent to the National Association of Retail Druggists at Chicago, and

the secretary, Mr. Wooten, then placed the name of this retail druggist upon what was known as an 'aggressive cutter's' list, and this aggressive cutter's list, with his name thereon, was sent to all proprietors, members of the Proprietary Association of America, and all the wholesalers, members of the National Wholesale Druggists' Association, with the request that they cease selling any drugs whatever to such an aggressive cutter; and it was further established, in case any proprietor or wholesaler, after receiving this notice from the Secretary of the National Association of Retail Druggists, failed to obey and cease selling to such an aggressive cutter, this information of his failure to obey also found its way to the secretary of the National Association of Retail Druggists and such disobedient proprietor or wholesaler was disciplined by being put on what was designated as a 'pink slip,' and his name was sent to all retailers throughout the United States with the information that he had been selling to aggressive cutters, and the request made to the retailers throughout the country to cease making any further purchases from such delinquent wholesaler or proprietor."

A similar pool was disclosed through the suit brought by the Bobbs-Merrill Company against one of the proprietors of R. H. Macey and Company of New York City.¹³ In this case the American Publishers' Association and the American Booksellers' Association each representing about 90 per cent of their respective business fields entered into mutual agreements to sell books only at such prices as were agreed upon. The court held the agreement to be invalid at law.

Railroads also have used this form of pool to institute uniform freight rates. These rate agreements were some of the first to be attacked by the government under the Sherman Act. The first of these pools was the Trans-

¹³ *Bobbs-Merrill Co. v. Strauss et al.*, 139 Fed. 155.

Missouri Freight Association, founded in 1889 by some sixteen railway companies operating throughout the territory lying between the Missouri River and the Pacific Coast. The agreement is described as "a contract between railroad companies forming the association to establish and maintain such rates, rules and regulations on freight traffic between competitive points as a committee of their choosing shall recommend as reasonable." It provided for monthly meetings composed of one representative of each company. These were vested with power to set the rates. Each company was required to give five days' notice before a monthly meeting if it desired a change of rates. If voted down, it was to give ten days' notice before putting its notified rate into effect.¹⁴

The railroad companies in the northeastern part of the United States attempted the same type of pooling arrangement through the Joint Traffic Association which was organized in 1896.

7. Patent Pools. — Companies owning patents under which certain commodities were manufactured have frequently pooled these patents, placing the ownership or control of the patents in a corporation which then gave a license or right to manufacture under all of the controlled patents. Such an organization was the National Harrow Company.¹⁵ This company was formed to take over patents under which ninety per cent of the spring-tooth harrows produced in this country were manufactured. The former owners then were given licenses under which they might manufacture spring-tooth harrows provided that they did not sell their product at lower prices or on more favorable terms than were stipulated in the license agreement.

¹⁴ *United States v. Trans-Missouri Freight Association*, 85 Fed. 59.

¹⁵ *National Harrow Co v. Hench et al.*, 83 Fed. 36.

The licensees were the sole stockholders of the National Harrow Company. The Indiana Manufacturing Company was the key unit in a similar pool. This company controlled twenty-one American and two Canadian patents and licensed its stockholders to manufacture pneumatic straw stackers and threshing machines under them. It also stipulated sale under uniform prices.¹⁶

8. Open Price Pools. — This type of a pool is said to be the invention of Mr. A. J. Eddy, a Chicago lawyer, who defines an open price as "a price that is open and above board, that is known both to competitors and customers, that is marked wherever practicable in plain figures on every article produced, that is accurately printed in every price list issued — a price about which there is no secrecy, no evasions, no preferences."¹⁷ He holds that the instability and disorganization of business are due to ignorance or misinformation as to actual market conditions, cost of manufacture and marketing methods, and that coöperation accomplished by open prices is the remedy. To this end he has been instrumental in causing scores of open price associations to be formed. They exist today in the cotton textile, woolen, lumber, iron and steel, leather, milling and numerous other industries.

Each member of the association sends to the secretary a report covering his sales, prices and terms. These are then taken up at the regular meeting, which may be monthly or oftener, and deviations from the average are fully discussed. In this way it is hoped to convince a "price cutter" of the error of his ways and to bring him up to the general average. The associations are cautioned against discussion of future prices lest they run counter to the Sherman Act. Nevertheless, it has been brought

¹⁶ See *Indiana Manufacturing Company v. J. I. Case Threshing Machine Co.*, 148 Fed. 21.

¹⁷ A. J. Eddy: *The New Competition*, p. 110.

out through court cases and hearings before legislative committees,¹⁸ that the urge to agree on future prices and to cause the average to creep up through one means or another is too strong to be resisted. Such for example, was the case with the Yellow Pine Association, the Steel Erectors' Association and the Portland Cement Association.¹⁹

The famous "Gary Dinners" of the members of the American Iron and Steel Institute constituted a similar type of pool. The steel masters would meet at dinner at the invitation of Judge Gary, usually in New York City, and there they would discuss prices and conditions of business in the steel industry. It was considered to be a violation of a gentleman's word of honor, should he digress in any way from the prices and percentage of capacity of production considered to be most desirable for the welfare of the industry. Everything that was said at these meetings was usually given out to the press for publication. The plan was abandoned when it became apparent that the courts considered it to be in violation of the Sherman Act.²⁰

THE KARTELL OR SYNDICATE

The kartell or syndicate, is the European counterpart of the American pool. It is essentially a combination of the federation type formed by agreement between autonomous establishments that delegate to the kartell control over certain aspects of their business. Such agreements have the sanction of the law, by virtue of which they are

¹⁸ See reports of the Lockwood Committee of New York State Legislature, 1920-21.

¹⁹ In the case of *American Column & Lumber Co., et al. v. United States*, decided at the October Term (1921) of the Supreme Court, it was held that the open price association is a combination in restraint of trade under the Sherman Act.

²⁰ For an account of what took place at these dinners see Stevens, *Industrial Combinations and Trusts*.

made enforceable in the courts like any other valid contract, regardless of their monopolistic character. In this particular they differ from the American pool which, if it can be shown to be monopolistic or even in restraint of trade, is unlawful and hence unenforceable at law. They are further strengthened by the fact that the governments of such countries as Belgium, Germany, Sweden, Switzerland and others, encourage their formation, and frequently even themselves become members. The life-term of these agreements is most frequently five or ten years, at the expiration of which it becomes necessary to negotiate a new contract.

The purpose of kartells is to bring about a closer correlation between the supply of, and the demand for, a given commodity. For this reason they are usually built up about a particular article of commerce. Thus, prior to the formation of the German Steel Syndicate (*Stahlwerksverband*) the steel plants were members of several different kartells concurrently, embracing, for example, rails, structural steel and billets, respectively. Beside these there existed at times kartells for heavy sheets, light sheets, wire and other commodities. In the glass industry there are kartells for bottles, mirror glass, and other such special articles.

The greatest obstacle standing in the way of kartellization is special interest. The combining units are not always all in the same stage of technical development. In almost every branch of production isolated establishments that produce but a single commodity will be found to exist side by side with those that have integrated to such a degree that they have extended the variety of their products almost to the limit. Even today one still finds in the steel industry unit blast furnaces, sheet mills, hoop band plants and rod mills, even though this is one of the most highly integrated industries. Where such conditions

persist the problem of reconciling the peculiar interests of some with the general interest of all is one that all but defies solution.

In view of these obstacles, Dr. Heinrich Mannstaedt²¹ lays down the following rules governing the formation of kartells: If the kartell is to be built up about a given article, this article will be the more susceptible to kartellization the less of individual peculiarities it possesses, and the more closely it corresponds to the products of other establishments. From this it follows that kartells can be formed most easily in those branches of production in which competition is keenest and where the law of mass production is most freely applicable. Because of the widespread use of automatic or semi-automatic machinery in the lower stages of production, these must suffer most from over-production and are ready candidates for kartellization. In contrast to them, those branches of industry, like machine manufacture, the products of which possess great individuality, making them less susceptible to irregularity of production, are not easily kartellized. Under such conditions the kartell must be organized about a single commodity selected from the general mass of products.

Types of Kartells. — According to the same economist, a study of German kartells shows that four methods are commonly employed to make them effective. A single kartell, however, may use two or more of them at the same time. As the following brief description will show, they differ little from the methods used by our own pools.

(1) *Agreement on sales price and conditions of sale* was common among the earlier kartells and is frequently used even at the present time. But it has not proved very successful, since it provides no means whereby production may be curtailed to prevent an over-supply. For this

²¹ Heinrich Mannstaedt, *Ursachen und Ziele des Zusammenschlusses im Gewerbe*.

reason they usually break up when a general slump in prices sets in. However, there are exceptions, notably the Upper Silesian Coal Syndicate which enjoyed a continuous existence for more than twenty-five years. This may be accounted for in part by the fact that it embraced only coal that was shipped by rail or water out of the district, exempting such as was needed to supply the local industries. Besides, the number of members was small, including but fifteen mines, all of which produced a very uniform commodity under approximately identical conditions. In other districts of Germany, as for instance in the Rhineland and Westphalia, where great variations exist not only in the method of mining but also in the quality of product, the pure price and conditions kartells have seldom continued for a long period of years.

(2) *Territorial division of markets* has in many cases supplanted, and in others supplemented the above method. Under this method, if the producing establishments are large, each has a monopoly over a given territory; and if they are relatively numerous and small a given territory is usually assigned to a group of them. In the latter case it is customary for each group to draw up a supplementary agreement to govern the operations of its several members. The market area is ordinarily delimited by freight charges.

(3) *Pooling of profits* has also been tried with some success. To make this operative two prices are agreed upon, namely a basic price and a minimum sales price. The basic price approximates the cost of production and may vary from establishment to establishment. Each member then pays into the kartells' treasury the difference between his assigned basic price and the minimum sales price. The latter price is not made obligatory upon the members who may sell their product for more or less, but it serves merely to measure the amount that must be turned over to the kartell. This sum is then periodically distributed

among them according to their production. The chief advantage of the plan is said to come from stimulating improvements in technique by which the members seek to force their production costs below the basic price. For this reason this method is generally used to supplement and round out the kartells that are based primarily on the other methods.

(4) *Restrictions on production* have figured prominently in the formation of the more recent kartells. In general, these kartells employ one of two practices; they either cut down the working time or fix a maximum output that is to be pro-rated among the several members. Where the time factor is used as a base it is applied in some such way as reducing the number of hours in the work day, reducing the number of work days per week or limiting the number of hours per day per week during which the machinery used to produce the article may be operated. Where the maximum output method is used the total output is arrived at from the standpoint of the market demand. Each member is then allotted a quota based either on previous actual production, or on capacity for production. The first of these methods is not as effective as the second because it tends to bring about a greater intensity of production which may result in a failure to reduce the total quantity produced. On the other hand, the second method also has its difficulties. It is easy enough to reduce the total output and in this way the quota of each member, for the latter is usually a percentage of the total. Nevertheless, there is constant friction because the plan makes little or no allowance for improved methods of production and technical efficiency. And whenever the kartell agreement comes up for revision or renewal, there is always a fierce fight for readjustment of quotas. In the coal industry this demand for larger quotas on the part of the larger, more efficient mines has caused many of them to buy out their smaller

and less efficient competitors in order that they might add the quotas for the latter to their own.

Where integrated establishments become members of this type of kartell they usually demand that raw materials, which they work up themselves, shall be included in the agreement only to the amount of the surplus which they do not use. Dr. Mannstaedt,²² for example, states that certain mixed steel works became members of the pig iron syndicate formed for export purposes in 1879, by the producers of Lothringen and Luxemburg. Under the agreement, they were permitted upon due notice to the syndicate to withdraw the pig iron that they themselves used. During the period of business activity that began in the decade, 1890-1900, it chanced that these steel works were late in notifying the syndicate of the amount of pig iron that they required for their own use. When the notice did come, they were advised that the syndicate had already contracted to sell this quantity to foreign buyers. Thus, in the face of their own pressing need, these plants were obliged to deliver their iron to the kartell. The outcome of this was that the steel works demanded a change in the agreement when negotiations for renewal of the syndicate were begun in 1900. They desired to remain active members of the syndicate without having definite quotas assigned to them, but wanted also the right to turn their surplus over to the syndicate for sale. The only obligation they wished to assume was not to sell any pig iron except through the syndicate. These proposals were unacceptable to the pure blast furnaces. Finally, it was agreed that the steel works should participate in the syndicate only to a predetermined amount of their total production, exempting what they needed for their own use. They also were given the privilege of withdrawing portions of their quotas from syndicate control by the other members.

²² *Ibid.*

In the Westphalian Coal Syndicate the integrated members profited at the expense of the unintegrated. During the industrial depression of the early nineties the demand for coal dropped enormously while the syndicate refused to reduce prices correspondingly. The small mines were hard hit, while those that used their own coal in their accessory undertakings were able to mine at somewhere near capacity by concentrating on the manufacture of non-kartellized products which they disposed of abroad at cut prices.

Integration by Kartells.—Under modern industrial organization horizontal combinations of producers of a given commodity find that control over production alone does not suffice to stabilize the market. Consequently they reach out to control also its distribution, because competition between distributors may be almost as upsetting to market prices as competition between the producers themselves. We have already seen how some of our pools, notably that controlling the manufacture and sale of patent medicines followed this practice. The same condition is found to exist in the larger kartells such as the Rheinisch-Westfälische Kolensyndikat and the Stahlwerksverband.

The above named Westphalian Coal Syndicate has binding agreements with wholesalers whereby the latter pledge themselves to place with it orders of uniform size at more or less regular intervals. In order to reduce competition between these wholesalers as far as possible, the syndicate divided its territorial market into 29 districts, and not only assigned a given district to certain of these wholesalers, but even allotted to them the disposal of certain of its producing members. But, because a few dealers did not come in on these agreements, the wholesalers of the Kassel District, with aid of the syndicate, in 1896 formed a limited company under the name "Glückauf." The others soon

followed, and by 1912 there were ten such coal selling companies coöperating with the syndicate. They are more or less under the control of the syndicate, which, however, pledged itself to sell its coal only to them within their assigned districts. The former independent dealers pledged themselves not to set up new coal selling establishments. They participated in the business of the companies in the same proportion that the sale of coal of each bore to the total sold by all, and the profits were distributed on the same plan. The conditions of sale under which the companies were to sell their coal were brought into close correlation with those of the syndicate. In several cities the coal retailers followed the example of the wholesalers by organizing similar companies.

Another feature of the organization of this kartell consists of the Rheinische-Kolenhandels- und Reedereigesellschaft,²³ commonly called the "Kolenkontor." This company was formed in 1904 to stabilize prices and control shipments of coal by water on the Rhine and by rail to South Germany, Switzerland and parts of Austria. Ocean shipments and those reshipped to Belgium and France were not included. The membership of the "Kontor," in addition to the Syndicate, included the four "Reederzechen," that is to say, Franz Haniel & Company, Mathias Stinnes, Hugo Stinnes, and the Bergbau- und Schiffahrts-Aktiengesellschaft, which own the transport facilities jointly. These four concerns, however, participate in the Syndicate only to the extent of the coal handled.

Distribution of Kartell Organizations. — Continental Europe is the home of the kartell, for there it enjoys the full protection of the law. But even so, it has attained a prominent place largely only in those countries where the influence of the German industrial organization is strong.

²³ The name Reederei is used to designate a partnership or company engaged in owning and operating inland or coastwise vessels with or without the necessary dock facilities.

Thus we find a great many of them in Switzerland, Holland, Belgium, Sweden, Denmark, Austria, Czecho-Slovakia and Hungary and also some in Italy. However, in Germany they appear to have been, and to large extent still are, the favorite form of organization. According to the government reports, there were in that country, in 1916, over 500 kartells exclusive of the loose organizations effected through factors' agreements. Most of them are highly centralized organizations that place considerable power of control in the hands of the kartell.

Although kartells and pools have not been unknown in England in the coal, iron, cement, porcelain, wall-paper, textile and chemical industries, these generally have been very loose price and production kartells of a temporary nature. The relative absence of kartells in England is ascribed, by Professor Liefmann, in his monograph on Kartells and Trusts, to (1) the stringency of laws against organizations and combinations in restraint of trade; (2) the individualistic conception of enterprise based upon the English economic teachings that free competition is the natural economic condition; (3) the effect of free trade, making it almost impossible to have a higher price at home than abroad; and (4) geographic conditions that make it easy for foreign competition to reach nearly all parts of the United Kingdom, and also make the establishment of definitely circumscribed markets very difficult.

EFFECT OF FEDERATION ORGANIZATIONS UPON INDUSTRY

Federation organizations are by no means an unmixed blessing to the industry in which they occur. There are certain outstanding advantages as well as disadvantages attendant upon their use. But on the whole it may be said that the advantages predominate — a fact that is clearly

brought out by a brief consideration of both sides of the question.

Advantages. — The possibility of exercising a direct influence upon the establishment of an artificial price and the relative freedom from the exasperating fluctuations in business that are brought on by the unimpeded play of the laws of supply and demand, are perhaps the most important advantages that federation organizations have to offer their members. The members are thus in a position to take advantage of a period of growing business activity to effect a steady and gradual increase in prices without the necessity of continually keeping an eye on the action of competition. Also, during periods of business depression, which are usually accompanied by a rapid fall in prices, the federation is able to retard the rapidity of decline and, in a measure, to prevent the laying off of large quantities of labor by shortening hours or reducing the number of work days per week. The greater uniformity in prices and closer correlation between supply and demand also lessen the capital risk, thus drawing new capital into the industry. For the same reason pools and kartells, where they are more or less permanent, have a tendency to force up the price of the securities of member companies. Furthermore, the members can benefit materially through federation agreements covering terms of sale, methods of payment, rebates, extension of credit, charges for packing, etc. Such standardization can become a lasting social and economic benefit to the community at large as well as the industry about which the federation centers.

Disadvantages. — By entering a federation organization the individual enterprise must necessarily sacrifice some of its independence and disclose many of its business methods to its competitors. But on the other hand, this sacrifice of independence does not go far enough in certain directions. During periods of prosperity the members of the

kartell or pool usually have a free hand in carrying out extensions to their establishments in order to increase their productive capacity. And even in periods of depression they frequently do the same thing so that they may be in a position to take full advantage of the market when business picks up. The natural result is that the combine finds itself unable to dispose of the product forced upon it and dissolves, throwing the members back upon a competitive basis, in a worse condition than they were before. Of still greater disadvantage is the growth of independent establishments of a like character. These, where they can maintain themselves, can take advantage of the combine's high prices by barely under-bidding it, while they remain free from the limitations and restrictions imposed upon the members. Unless a monopoly over the product is secured, there is no way in which the rise of such independents can legitimately be controlled. Consequently, the federation stoops to the use of all kinds of questionable and illegal methods to suppress this new competitor or is forced to take him into the fold.

Another disadvantage, more particularly from the employer's point of view, but not necessarily from the social side, is the marshalling of employees as a body against the members of the federation. Naturally, when the establishments in an industry have combined to form a strong pool or a kartell, each member is less free to handle his own labor problem. The employees, realizing this fact, take advantage of the situation to bring pressure to bear not alone on the combination, but through it upon its individual members. In the end, the employees will make their demands upon the industry as a whole rather than upon individual employers. The more or less direct effect upon the workers is to bring about a greater uniformity in wages and working conditions as well as a greater regularity of work. The benefits that may thus accrue to

labor through well regulated combinations of this type must not be overlooked. On the other hand, the control company and trust, when at the head of fully integrated industries, are in a position to dictate to their employees and to carry on a labor war with much greater effectiveness than the federation.

CHAPTER XV

SUBSTITUTION OF SECURITIES: INVESTMENT COMPANIES

WHERE the outstanding securities of one or more companies are acquired from the holders thereof by another company that gives its own securities in exchange, thus substituting a new medium through which the income derived from the underlying capital is to be distributed, there is an application of the principle of substitution of securities. The types of ownership organizations through which this may be accomplished must, quite obviously, be securities-issuing organizations that are empowered to hold the securities of other business organizations. Of these, the holding corporation is the outstanding favorite, though the holding trust is also extensively used. The joint stock company, due to its lack of distinct legal entity, is ill adapted to the principle, and in consequence it is seldom employed.

The direct effect of an application of the principle of substitution of securities by ownership organizations that enjoy legal entity, is very complex. Simply stated, it results in a combination of the claims to income accruing to the invested capital underlying the securities, and of the claims to a proportionate share of the capital itself; and there is inherent in it the possibility of complete centralization of control over the enterprises concerned. In other words, it substitutes, as claimant, a single legal entity in place of the former security holders and vests that entity with all of their rights, powers and privileges as

holders of ownership or creditor securities. But these rights, powers and privileges are in turn indirectly transmitted to the holders of the securities that the holding organization issues. A simple illustration will serve to make these points clear.

A holding company D acquires the securities of corporations A, B and C from their stockholders, who receive corporation D's securities instead. The holding company's assets now are the securities of corporations A, B and C, but they are in turn supported by the capital investments of these three subsidiaries. The income accruing to this capital still goes directly to the subsidiaries which, however, transmit it to the holding company in proportion to its holdings of A, B and C stocks. Then, this company in turn redistributes it among its own stockholders. These stockholders, who have exchanged their A, B and C stocks for D stock, now have, in the final analysis, three sources of income, where formerly, each group — A stockholders, B stockholders and C stockholders — had each but a single source of income. Thus, any differences in the dividend-paying ability of the three original companies have been averaged up through the medium of substitution of securities. The claim of the stockholders to the capital of the enterprises involved has undergone a similar change. Their first claim is on the securities capital of the holding company, and through this the claim reverts to the business capital of the subsidiaries. Their control over the holding company gives them in like manner control over the subsidiaries; for the holding company owns the majority of the stock of companies A, B and C and, therefore, controls them.

Turning from the economic to the legal results, the first thing that strikes the mind is that the legal entity, or being of the subsidiaries has not been destroyed, and that a new legal entity, the holding company, has been created.

Each one of these legal entities must have its own capital assets. Each of the subsidiaries owns its own plant and equipment in its own name—in other words, each has a legal title in a definite accumulation of economic capital—assuming of course that they are primary or operating companies. The holding company's assets are the securities of its subsidiaries. To these only does it have the legal title. But as a stockholder in each of the subsidiaries it enjoys all of the rights and powers embodied in that relation, including a claim on the basic capital.

We may, then, restate the results of the process of securities-substitution to be:

1. The continuance of legal title to definite accumulations of basic underlying capital in legally independent ownership entities.
2. The combination, either in whole or in part, of such accumulations of capital into an economic business unit.
3. The legal unification of proportionate claims to income accruing to such capital and
4. The possibility of a centralized, unified, control over it.

Participation as an Application of the Principle of Substitution.—That there is more than one use that may be made of the principle of substitution of securities has already been indicated in the preceding paragraph. In the first place, it may be employed to create a more or less permanent relation between the several companies involved, so that the holding company becomes a *participant* in the enterprises conducted by the companies whose securities it holds. In the second place, the arrangement may be characterized by its temporary nature, being employed merely to facilitate the accumulation of sufficient capital by the companies whose securities are held, the ultimate aim of the holding company being to sell these securities finally to permanent investors. In such cases the holding

company does not aim to become a participant in the enterprises of the other companies, but renders them a service by furnishing the money capital to be converted into business capital, namely, it *finances* them. These two uses of the securities-substitution principle may thus be said to give rise to two classes of holding companies, namely; (1) *participation companies* and (2) *finance companies*.

Kinds of Participation. — Participation through substitution of securities may be either partial or complete; and it may arise merely out of a voluntary desire, or out of economic or legal necessity. Present day practices present three distinct applications of the participation principle, each of which gives rise to specialized companies through which they are brought into use.

A. The first use of participation is to minimize as much as possible the speculative features that characterize most securities and in this way to widen the market for them by making them appeal to small investors. A particular issue of securities may have a high rate of return; another, a low rate; a third, may exhibit irregular fluctuations, while still a fourth gives a regular, stable, income to the holder. By combining the earnings of a large number of various types and kinds of securities the varying rates of return from individual units may be averaged, the high interest and dividend rates counterbalancing the low. A wealthy capitalist is in a position to apply this law of averages for himself to his investments in securities; but a small investor is in no position to do so. He must take a chance unless some other agency applies it for him. This may be accomplished through participation by substitution of securities. For instance, a holding company may issue its own securities to investors and use the funds received from them to purchase a great variety of securities in the market, or to purchase them directly from the issuing organizations. It then derives its income from the large number of

enterprises whose securities it holds and transmits it to the holders of its own securities in averaged form. Such a procedure is an application of the *investment* principle to securities capital, and the holding companies performing this function may very properly be called *investment companies*.

B. The second use of the participation principle arises out of a desire to establish a unified control over one or more securities-issuing organizations through the acquisition by the holding company of all or a majority of their voting stocks. In operations of this kind there is naturally a tendency to make the participation as complete as possible, giving it more the character of true ownership. In the United States, this is the chief purpose for which the security-holding power has generally been requested. For this reason the name "holding company" has come into general use to designate participation organizations of this type. However, in order to distinguish them clearly from the other types of holding companies, they will here be called *control companies*. Where the participation of the control company in other companies is only little more than a majority control, the latter are usually designated as *controlled companies*; and where it is complete or very nearly so, they are known as *proprietary companies*.

C. The third use arises out of the existence in certain industries of economic or legal conditions that make it impractical to issue the securities of operating companies directly to the public. In order to effect the "*securitization*" of capital invested in such undertakings, it becomes necessary to interpose between the final investor and the organization directly conducting the enterprise a secondary securities-issuing company that can assume, as its permanent business capital, the securities of the operating concerns. To this type of participation company is given the name, *assumption company*.

Commenting upon the occurrence of these three types of participation companies and their distribution throughout the world, Professor Robert Liefmann,¹ a recognized authority on the subject, says: "It is noteworthy that, today, in each of the great commercial and industrial countries some one of these three types of companies is conspicuously prominent. England is the land of the investment trusts and investment companies. In America, control of other undertakings is almost exclusively the purpose for which the substitution of securities is employed. In Germany the securities-assumption companies have attained a prominence that far surpasses any that organizations for the accomplishment of like ends in other countries exhibit. But any single one of these three types of participation companies is not to be found exclusively in its respective country. There are in England also some control companies; in America also some investment companies, though they emanate chiefly from England, and also a few securities-assumption companies; in Germany also a few control companies. But of the three types described, each one is, respectively, predominant in some one of the three countries, so that each type may be regarded as characteristic of a given country. Of other states where securitization of capital has developed, France has a number of investment companies, and the principle of securities-assumption also has attained some development. Belgium, to the contrary, has followed the German example and has a larger number of assumption companies because it has developed just that particular field for capital investment in which the system of assumption companies plays the chief rôle (electric light and power establishments). Holland, as an interest receiving state, follows the French plan and has a number of investment companies.

¹ R. Liefmann, *Beteiligungs- und Finanzierungsgesellschaften*, Sec. Ed. 1916, pp. 78-79 (Translation by the author).

In Switzerland, chiefly as a result of outside influence, a whole array of investment and assumption companies have been formed. In all other countries, the principle of substitution of securities has at times been used in one or another of its several different forms, but these have not as yet attained a sufficiently advanced industrial development to permit of ascribing to them, with any degree of certainty, any marked tendency of development in one or another direction."

It is quite apparent that a participation company need not confine its activities to any one of these three uses to the exclusion of the others. Indeed, it is very common to find a single company performing two and sometimes even all three of these services. Nevertheless, there are a large number of companies that are distinctly representative of these several types. A brief description of some of these companies will serve to illustrate the practical use made of them.

INVESTMENT COMPANIES

England is the great home of investment companies. They have been in use in that country since 1868. From that time on they increased slowly in number for about two decades. In 1888, however, began a period of very rapid growth that was checked only by the advent of the crisis of 1892. Since 1897, they have again become prominent features of the English business world, and in 1911 there were over 125 of them listed. Their adoption by other countries has been rather limited, with the possible exception of France, where they are fairly common.

English Investment Companies.—A study of the extent and kinds of holdings of English investment companies leads one to the conclusion that there are two general classes, namely; (1) those that carry on a general investment business by purchasing securities of enterprises engaged in many industrial and commercial fields;

and (2) those that confine their holdings to particular industries, and sometimes even to particular localities. The latter class seems to be the general favorite, invading such industrial fields as railways, mining, colonial exploration and development projects, petroleum, tea, rubber, nitrate, wireless telegraph undertakings and ocean transportation.

Another characteristic of British investment companies is the extensive use made of the securities-issuing trust as the holding organization in which the title to the securities acquired is vested. They are in far more common use for this purpose than any other form of ownership organization.

Among the English companies that carry on a general investment business there are a number of excellent examples. The Stock Conversion and Investment Company, founded in 1889 with a capital of £857,000, to convert existing securities into several new classes, gave in exchange for a block of London and Northwestern Ordinary Shares three different kinds of stocks and bonds, and for a block of North Eastern Railway Consols two new classes of stocks. The company does not confine its activities exclusively to holding railway securities, but has also entered other fields. Other companies of this type are the United States and South American Investment Trust Company, founded 1886, with a capital of £1,325,000; the Foreign American and General Investment Trust Company, 1883, with a paid-in capital of £2,000,000; the Merchants Trust, Ltd., 1889, with a capital of £2,100,000 and the North American Trust Company, 1896, with a capital of £2,000,000. There is in the trust agreement of the last named company a provision that not more than ten per cent of its capital may be invested in any single issue of securities. A similar limitation is found in the Industrial and General Trust, founded in 1889, with a capital of £1,325,000. The trustees of this

company may not invest over three per cent of its capital in a single undertaking. The New African Company, 1894, with a capital of £283,000 is another good example of this type. It acquired the securities of seven undertakings including shares of the Marconi Wireless Telegraph Company and several railway, land and mining companies. The Caledonian Trust Company, 1910, with a capital of £811,000 to be invested in American securities, may not put more than 20 per cent of its capital in a single enterprise.

British investment companies that specialize in the securities of particular industries or regions are more numerous than the general type. Among those that specialize in mining securities are the Johannesburg Gold Fields, founded in 1889, with a capital of £162,000; the Oceana Development Company, that owns securities of the Balkis, New Charterland Exploration Company, the Van Ryn Mines and other enterprises of the South African Rand District; the Rhodesian Mines Trust, and the Diamond Mining Investment Company which owns diamond mine and oil securities. Most of these companies were founded since 1890. The shipping industry is represented by the Scottish Ship & Ship Share Investment Company, organized 1893 with a capital of £13,970. In the public utilities field is the American & British Securities Company with a capital of £180,000. The rapid development of rubber plantations in the East Indies has also given rise to a considerable number of investment companies such as the Rubber Share Trust & Finance Company with a capital of £350,000; the Anglo-Malay Investment Trust, £135,000, and the British North Borneo Rubber Trust with £1,000,000 capital. These companies, however, do not confine their activities entirely to investment but also promote rubber plantation undertakings. Regional investment companies are represented by the American Trust Company founded in 1902 with £1,769,000 capital and the African Trust, Ltd., 1905, with £200,000

capital. The latter holds securities of the Consolidated Rand Mines, Rhodesia Trust & General Exploration Company, East Africa Pearl & Sponge Company and others.

American Investment Companies.—In the United States there are few securities-issuing organizations that might be called pure investment companies. It has been the practice in this country to emphasize the control rather than the investment function, but the latter service is frequently combined with the former. This is conspicuously true of our railroad companies. For example, the Union Pacific Railroad Company operates 3,614 miles of railway in its own name, controls through two owned companies some 4,418 additional miles, and participates in the earnings of about 100,000 miles of railways owned and operated by most of the big railroad companies in the country. Among these companies, whose securities it holds as investments, appear the Pennsylvania Railroad, New York Central, Baltimore & Ohio, Chicago & Alton, Chicago & Northwestern, Great Northern, Chesapeake & Ohio, and Chicago, Milwaukee and St. Paul. The value assigned to the securities of these roads held by the Union Pacific, in 1919, was \$90,445, 272 in stocks and \$109,864,809 in bonds, which added to its \$16,362,050 of United States Liberty bonds, makes a grand total of \$216,672,131 in investment securities. This sum was about one seventh of its total invested capital. It is at once clear that this railroad company performs the investment function on a much more gigantic scale than the simple investment companies of Britain. Nor is this railroad an exceptional case, for practically all of the railroad companies mentioned in this paragraph have extensive holdings in other companies for investment purposes.

The pure investment company, however, also has made its appearance in the United States since about 1905. For instance the City Investing Company was formed in New

York in 1905 with a capital of \$5,000,000 to deal in real estate and to carry on a general investment business. It now holds large blocks of bonds, mortgages and stocks. The Federal Utilities, Incorporated, was chartered in 1911 under the laws of Virginia to hold stocks and bonds and other securities and properties of electric light and power and other public utilities. The original capital of \$1,000,000 was paid in in cash and this was used to acquire securities primarily for investment purposes. The Chicago Securities Company was incorporated under the laws of Delaware in 1912 with an authorized capital of \$800,000 to take over first mortgages on real estate and United States bonds and other securities.

Several large investment companies sprang up as a result of the World War. The American Foreign Securities Company was incorporated in 1916 in Delaware with an authorized capital of \$10,000,000. It then received from the French Government \$120,000,000 in various kinds of securities as security for a loan of \$100,000,000, which the company itself procured by issuing \$94,500,000 of its own three-year, five per cent, gold notes. A similar company is the Foreign Bond & Share Corporation organized under the laws of Delaware in 1919. This company combines the investment and financing functions. It is identified with a number of American private banking houses, and finances government and private undertakings in Central and South America and the Far East. While it is primarily a finance company, it nevertheless has large investments in securities which serve as basic capital for the securities that the company itself issues to the investing public. Its capital stock consists of 3,000 shares of no par value and \$10,000,000 of par value common.

Another company, very similar to the latter, is the American International Corporation, organized in 1915 under the laws of New York primarily to promote American foreign

trade. Its activities up to 1920, however, have been largely confined to investments in more or less speculative securities. It has large blocks of the International Mercantile Marine Company, the United Fruit Company, the United States Rubber Company, the New York Shipbuilding Corporation, the Pacific Mail Steam Ship Company, and the Simms Petroleum Company. The authorized capital stock — following English practice of issuing founders' shares to the managers — is divided into \$1,000,000 of "Managers' shares" which are 7 per cent, limited participating preferred stock and \$49,000,000 common stock.

However, the number of pure investment companies in the United States is exceedingly small in comparison with those in Great Britain. Neither among the several hundred thousand corporations nor among the numerous New England trusts do we find more than perhaps a score. Indeed, with us, investment appears to be a consideration secondary to control and assumption as ends sought to be accomplished through participation by means of substitution of securities. For the most part, the holding of securities for investment purposes in this country has been undertaken by the great insurance and trust companies. Several states, notably New York, 1906, passed laws requiring insurance companies to dispose of some classes of stocks, but the time limit set for this has several times been extended, and in 1920, these companies still held nearly \$150,000,000 in such stocks. Private banks also hold very large quantities of securities, but only in small part as pure investments. The federal banks, too, perform the same function to a less degree and indirectly in so far as they accept stocks and bonds as security for loans.

Investment Companies in Other Countries.—In continental Europe the investment company is also to be found; but it is chiefly restricted to France and Holland. In Belgium there are a few finance companies that assume

the investment function as a side line, represented by such banking companies as the *Société générale de Belgique* and the *Banque Belge de chemins de fer*. Those in Germany are inconsequential.

Criticism. — In theory, the investment company is in a position to render a valuable service to small investors by eliminating excessive risk from investment in securities; but in practice this theory seldom works out in such a way as to be entirely satisfactory. This is due, not to any inherent weakness of the investment principle, but merely to the fact that any type of ownership organization in business must be run by man, who is not infallible in his judgment of the future value of business undertakings. Another weakness militating against proper insurance of small investors who buy securities of investment companies lies in the fact that these companies are private undertakings usually operated by those who manage them, and who look first to their own private profit. This feature is emphasized by the extensive use of founders and managers shares which are usually held by those persons who were particularly interested in promoting such companies. Their stock is frequently guaranteed by a first claim to a fixed rate of dividend and on assets with right to share liberally in extra profits. This prospect of extra profit and security has led many managers of investment companies to put the capital into speculative securities, which as frequently as not prove unprofitable. For these reasons it is open to serious doubt whether the investment company really does render a service to modern industry that can not as well be left to the individual investor. The latter is no better equipped to ascertain the value and stability of the securities issued by investment companies than of those issued by operating concerns. It would, in most cases, be much safer for him to invest in the stocks of the big, firmly established industrials and railways, or in government bonds.

CHAPTER XVI

PRINCIPLES OF CONTROL

THE INSTRUMENTALITIES OF CONTROL

CONTROL over one ownership organization by another, while both retain their separate entities, is defined in a special report of the Interstate Commerce Commission¹ as *ability to determine the action* of the organization. In explaining what constitutes ability to determine action, the report proceeds to enumerate eight conditions, the existence of which in the relations between two or more organizations is evidence of control. These may be reclassified according to the instrumentalities that are employed to establish the condition of control in the following manner:

- I. By *contracts* whereby control over the property other than the instrumentalities of organization is secured, namely, by leaseholds giving the controlling organization
 1. The right to all property except the instrumentalities of organization
 2. The right to all such property except money and choses in action other than securities and
 3. The right to such portion of the tangible property as is capable of being employed to discharge the duties and functions of the organization.
- II. By *participation* through ownership of securities either in the form of
 - A. Voting control, by virtue of

¹ Interstate Commerce Commission, *Special Report No. 1*, Washington, D. C., 1908, p. 15.

1. The right to exercise the major part of the voting power attached to the securities
 2. The right to name the major part of the board of directors or managers, whether by virtue of a voting trust agreement or otherwise, or
- B. Foreclosure control, by virtue of
1. The right to foreclose a lien upon all the property of the organization
 2. The right to foreclose a lien upon the major part of the property.
- III. By *agreements* creating the right to determine the action of the organization in some specified respect or respects.

Control established by contract is not dependent upon any specialized form of organization, but may be instituted by any of the forms of ownership that have thus far been described, namely, by the personal ownership, the primary securities-issuing and the securities-substitution types. Because of its versatility it is difficult to assign contract control to its proper place. However, since, in practice, it is most frequently found to be used in conjunction with participation company organizations, it seems to be more logical to describe it in connection with that type than any other.

Participation control is by far the most common type to be found in this country, where it is used to such an extent, through the instrumentality of the holding corporation, that control may be said to be the chief use made of that form of organization.

Control by agreement includes several types of arrangements ranging from informal inter-organization agreements to formal agreements creating such forms of organization as associations, pools and kartells. These seldom result in so complete a control over the organizations affected as is possible under the first two classes.

CONTRACT CONTROL

In no other field of enterprise is control through contract of leasehold so common as among the American railroads. There is scarcely a single great railroad system that has not at least in part employed this method of control to build up and to consolidate its railway mileage. This condition arises from several circumstances. In the first place, railways, like all transportation enterprises, are very often dependent upon one another for business. A given company may operate a section of line connecting two other roads while most of its business originates in sections of the country that it does not reach. Again, in certain sections of the country, especially in the North and the South, there are innumerable short lines that serve merely as feeders to main line companies. These frequently lack complete equipment and are economically dependent upon the larger companies in this particular. It is only natural under such circumstances that the larger companies, operating great systems, should seek to secure this additional trackage for their own use without incurring the expense of purchasing it or acquiring the companies that own it. As a result, they lease such properties on an annual rental basis for long periods of time.

In the second place, a railroad, as are all public utilities, is practically a natural monopoly. Two railways can not well serve the same territory and return profit on their investment. Over long distances, it is true, they compete, as in the case of roads running from New York City and Philadelphia to Chicago, and from Chicago to the Puget Sound. But between these terminal points there is very little competition. As a result of this characteristic, the urge is extremely strong to acquire the use and control of roads already built rather than to build new ones. Here the leasehold offers the simplest solution.

The most prominent example of leasehold control in this country is to be found in the Southern Pacific railway system. In 1894, the Southern Pacific Company secured from the Central Pacific Railroad Company, through a 90 year lease, control over all of the properties, including 2,289 miles of line of the latter company. It pays for this right a fixed rental of \$10,000 per year and out of the net profit, after operating expenses, maintenance and interest charges have been paid, 6 per cent on the capital stock to the lessor company. If earnings exceed that amount the surplus is divided equally between the two companies. In 1914, the arrangement was attacked by the Department of Justice as contravening the provisions of the Sherman Anti-Trust Act, but the decision of the court upheld the agreement as lawful.

As illustrative of the continued existence of the legal entity of the lessor organization under such agreements, it is well to point out that the Central Pacific Railroad Company was reorganized without disturbing the control over its properties by the Southern Pacific Company. In 1899, the original lessor company was dissolved and the title to its properties was acquired by the Central Pacific Railway, organized in that year in the state of Utah.

Most of the railway companies operating in the North-eastern part of the country have leased the lines of many smaller companies. The Delaware, Lackawanna and Western Railroad Company in this way controls some 14 companies with a total mileage of 702.6 miles. The larger units among these companies are the New York, Lackawanna & Western Railway, 214.4 miles, the Morris and Essex Railroad, 119 miles, the Utica, Chenango and Susquehanna Valley Railroad, 97 miles, and the Syracuse, Binghamptom and New York Railroad with 81 miles of line.

There are also instances where the leased lines comprise

practically the entire plant and equipment of the leasing company. This is the case with the Cincinnati, New Orleans & Texas Pacific Railway Company, organized in Ohio in 1881 for the purpose of taking over and operating the properties of the Cincinnati and Southern Railway. This railway was constructed by the city of Cincinnati, which leased it to the former company for a period of 25 years in 1881. In 1902, the lease was renewed for a period of 60 years from the date of expiration of the original lease. The city derives an income of somewhat over \$1,100,000 annually as rental for this railway.

Among industrials lease control is found to be as infrequent as it is frequent among railroads. Where it is employed by them it is usually for a short period of time with an option to buy the property when the lease expires. In 1919, the General Motors Corporation controlled the entire plant and equipment of the T. W. Warner Company under a three years' lease with option to buy. But such examples are relatively few and ordinarily involve property that has comparatively small value. Industrial undertakings, unlike railways, seldom enjoy a natural monopoly, and even their legal monopolies secured through patents and trade marks are respectively too short-lived and too delicate to be risked by giving the control over them to others.

By and large, it may therefore be said that leasehold control is essentially confined to industries in which the factor of natural monopoly is large. These would include, railways, public utilities, dockage, wharf and terminal facilities, and mines.

PARTICIPATION CONTROL

The control arrangements effected through participation are all based upon rights that vest by virtue of the ownership of securities. Consequently, this method of

control may be brought into use only through such organizations as possess the power to own and dispose of the securities of other organizations. But, since it is necessary to provide some means by which the claim on income and assets acquired by the participant may finally be vested in natural persons, the process ordinarily involves the substitution of the securities of the participant control organization for those that it has acquired. There are but two types of participation organizations that have been extensively used for this purpose. These are the trust and the holding corporation. The joint stock company is rarely employed.

Instruments of Participation Control.—Control exercised through the voting power attached to stocks is by far more common than any other method. The percentage of stock that it is necessary to own need not always be a majority, because by securing a sufficient number of proxies it is a simple matter to secure the votes without owning the stock. Thus, it was possible for the New York Central and Hudson River Railroad Company and the Pennsylvania Company, in 1906, to control the Reading Company through subsidiaries, although together they owned but 43.4 per cent of the total outstanding stock of the Reading Company.

However, through a proper classification of stocks it may be so arranged that but a small ownership interest is necessary to control a very large and ramified organization. This method may properly be called *pyramided control*. For example, the Rock Island Company was so organized that the holders of but \$25,000,000 of its preferred stock could control the entire Rock Island System with its 15,000 miles of railway and its \$1,500,000,000 capitalization.² This was possible because the preferred stock was given the right to elect the majority of the board of directors.

² See chart, p. 314.

Provision is also frequently made whereby the holder of a mortgage bond issue shall have the right to appoint a managing director for the debtor company. Thus, the West India Sugar Finance Corporation, organized in Connecticut in 1913 to finance sugar corporations in the West Indies by advances secured by mortgages, usually provides in its indentures for control, or at least representation upon the board of directors, of the company whose creditor securities it assumes. A similar provision was made when the old United States Shipbuilding Company was organized in 1902. This company's capitalization consisted of \$25,000,000, common and \$20,000,000 preferred stock, and \$10,000,000 collateral trust bonds plus \$14,500,000 first mortgage bonds. The company gave \$20,000,000 of common stock and the \$10,000,000 collateral trust bonds to acquire the Bethlehem Steel Company. To give control to the former Bethlehem owners, it was provided that these bonds should have the same voting power as \$10,000,000 stock.

The voting trust has also been employed to concentrate control through participation. In 1906, the Interborough-Metropolitan Company was organized to consolidate the traction systems of New York City. It acquired practically all of the outstanding stock of the Metropolitan Traction Company through the New York Railways Company, the Metropolitan Securities Company and the Interborough Rapid Transit Company. For several years following its formation the company was controlled by a voting trust consisting of A. Belmont, W. Oakman, Thos. Ryan, C. Vanderbilt and P. Widener who owned \$93,200,000 of common stock, leaving \$45,700,000 of preferred stock and \$67,800,000 of bonds outstanding in other hands.

Foreclosure control is not uncommon, for it is customary to provide in the mortgage indenture that, in case of failure

of the company to pay the interest on bonds when due, the bondholders shall have the right to take over the control and operation of the corporation for a limited period of time, usually for a period of six months. Control of this kind, however, is merely temporary. Thus, the Southern Railway Company, in 1906, controlled the Macon and Birmingham Railway Company through default of the latter in the matter of interest on bonds secured by its property and held by the Southern Railway Company.

A similar right is sometimes given to preferred and debenture stock, examples of which are given in Part VI of the text. An exceptional use of this type of securities has been made in the organization of the General Motors Corporation. This corporation had outstanding on January 1, 1920, the following stocks:

19,518,895	shares non-par value common
\$16,183,400	6% cumulative preferred
\$16,489,500	6% cumulative debenture stock
\$22,390,000	7% cumulative debenture stock

If the dividend is regularly paid on the preferred and debenture stock, the common stockholders retain control; but if it is lapsed on any of the other classes for more than six months, the holders of that class take over the control. The corporation itself is reported to be controlled by E. I. du Pont de Nemours and Company through its subsidiary, the Du Pont American Industries Company, largely through common stock holdings. Thus, a lapsing of the dividend on any other class of stock would shift the control of the General Motors Company from the du Pont Company.

Modes of Participation Control.—Inter-organization control through participation may be either *sole* or *joint*, namely, by a single organization or by several; and *direct* or *indirect*, that is, without the use of an intermediary or with one. There are, then, four modes of control: (1) sole

direct, (2) sole indirect, (3) joint direct, (4) joint indirect. The terms "joint" control and "indirect" control require some further explanation; the others are self-explanatory.

Joint Control. Where joint control exists, it is frequently difficult to determine whether participation in the controlled organization is solely for investment or primarily for control. Thus, the Lehigh and Hudson River Railroad Company, with an outstanding capital stock of \$1,340,000, in 1906, reported its stock to be held by the Lehigh Coal and Navigation Company, the Central Railroad Company of New Jersey, the Delaware, Lackawanna & Western Railroad Company, the Erie Railroad Company and the Pennsylvania Railroad Company. But of the six companies, only the Erie conceded the relationship to be that of joint control, the others claiming that it was of the nature of an investment.³ Similar joint control by numerous railroads is to be found in most union station and terminal railway projects.

The fact that minority holdings are often in a position to control results in some peculiarly complex situations in cases of joint control. In 1906, the Des Moines Union Railway Company is reported to have been jointly controlled by the Chicago, Milwaukee & St. Paul Railway Company, the Wabash Railroad Company and F. M. Hubbell, Son & Company,⁴ in spite of the fact that the latter company owned five eighths of its stock. The St. Paul owned only two eighths and the Wabash one eighth. Under the charter of the Des Moines Company it required at least seven eighths of the outstanding stock to elect a director, to amend the charter, or to increase the capitalization. Hence, the smallest stockholder was as much in control as the other two combined.

³ Interstate Commerce Commission, *Special Report No. 1*, Washington, 1908.

⁴ *Ibid.*

Indirect Control. This method of control results in extreme complexity of inter-relation between ownership organizations. It may be instituted: (1) Through one or more intermediary holding companies; (2) through a trustee or an individual or individuals in a fiduciary capacity with respect to the controlling company; (3) through a so-called "family interest" heavily interested in the companies concerned; and (4) through fictitious or non-existing persons.

(1) *Control through intermediary companies.* Where an intermediary company is employed to effect control, such a company must have the power to hold the securities of other companies. This is the means used by E. I. du Pont de Nemours & Company in its control over the General Motors Corporation, itself a holding company controlling some 55 companies and holding an important interest in 18 others. In 1917, the du Pont concern acquired 27 per cent of the stock of the General Motors and the Chevrolet Motor Company. The latter was subsequently acquired by the General Motors. In 1918, the Du Pont Company caused the Du Pont American Industries Company to be formed and transferred to this subsidiary its holdings in the General Motors. In 1920, the Du Pont American Industries Company acquired by purchase from the Durant interests what was reported to be a majority of the outstanding common stock of the General Motors, thereby giving control over the whole organization to E. I. du Pont de Nemours & Company.

The United States Steel Corporation also is built up after this same manner. Through its 11 great intermediary holding companies, this corporation controls, chiefly through ownership of all outstanding stock, nearly 150 other companies. The five great packers have made extensive use of this principle in acquiring control over some 669 concerns.

By successively placing one intermediary holding company in control of another, it is possible to build up the famous *pyramided*, or progressive, control that was so successfully used by a small group of financiers in the Rock Island Railroad System and in the Atlantic Coast Line, shown in the accompanying chart outlining the intercorporate control as it was in 1906. The Rock Island Company at that time had outstanding \$49,956,880 in preferred stock, which had the right to name the majority of the board of directors. Control of the system therefore lay in the hands of those who owned a majority of this class of stock. In the Atlantic Coast Line Company, an ownership of slightly more than \$5,000,000 of the stock of that company controlled solely and jointly through ownership and lease a railway system over 11,000 miles in extent, with a total capitalization of over \$725,000,000. (See page 314).

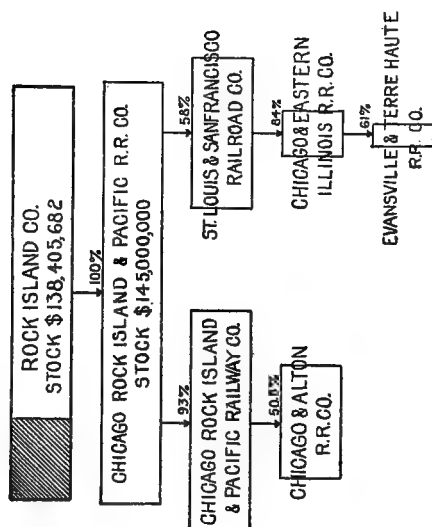
(2) *Control through trustees or fiduciaries.* Where a holding company owns the controlling securities of another, it may turn these securities over to trustees as a trust estate, with itself as beneficiary. If the trust agreement is properly drawn up, the holding company may then control the other by naming trustees who carry out its will. This practice was found by the Interstate Commerce Commission⁵ to have been used in a number of instances by railroad companies. It serves to cover up the true relation of control. More recently the Federal Trade Commission has uncovered numerous instances where one or more of the five great packing companies have used trusted individuals to hold controlling interests in other companies for them in a fiduciary capacity.⁶ Such individuals are called "dummy stockholders." The report of the Commission says, "Every one of the five big packing companies prac-

⁵ *Ibid* p. 19.

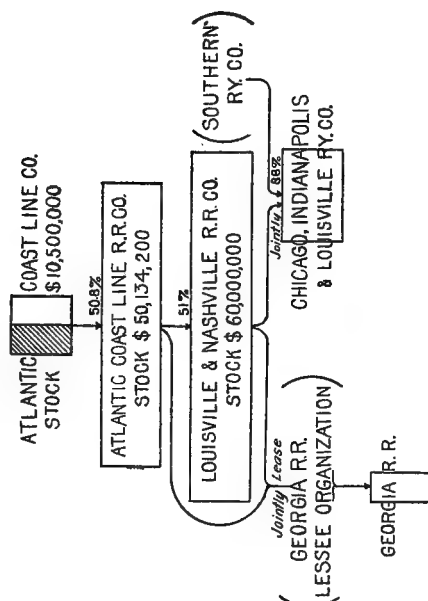
⁶ *Report on the Meat-Packing Industry, Part I*, pp. 264, et. seq.

PYRAMIDED CONTROL

ROCK ISLAND SYSTEM



ATLANTIC COAST LINE SYSTEM



The shading indicates the portion of stock necessary to control each system while the size of the rectangles shows the relative amount of stock that each company had outstanding in 1906. Only the more important units are shown, numerous other subsidiaries being omitted.

Adapted from charts published in Special Report No. 1, Interstate Commerce Commission, 1908.

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tices it to a greater or less extent. Even those whose State of incorporation permits direct holdings have subsidiary companies whose stock is held in the name of a trusted employee or attorney, or other party for the benefit of the primary company.

"Similarly stock investments by the individual members of the packer families or by the family estates are frequently held by dummies.

"The common practice in the case of dummy holdings is to record on the subsidiary or affiliated company's stock books the name of the dummy as a stockholder of record and to direct him to assign the stock in blank to the parent company or other person designated by the parent company, or to the members of the family who are the true owners. The stockholder of record, therefore, is the dummy, either a clerk or a confidential man of the real owners who directs the voting of the stock and receives all dividends."

In this way, Swift & Company and Armour & Company were reported to hold 50.3 per cent of the stock of the Record Stockman Publishing Company of Denver; the former through one H. A. Chetham, and the latter through one Guy S. Bailey, whose names appeared as stockholders of record. It was in this way, also, that the Morris interests concealed their control over the Kansas City Stock Yards Company. The bulk of the stock of the latter company was recorded as being owned by E. V. R. Thayer and Roy A. Hitchings, but was assigned by them in blank and turned over to the Estate of Edward Morris.

(3) *Control through family interest and individual holdings.* While this method of control does not involve participation by one company in another, it nevertheless is of sufficient importance to demand a word of explanation. Family interests are sometimes turned into trust estates by testament, as in the case of the estate of Jay Gould and

of Edward Morris. These estates, for all practical purposes, perform the same function as a holding company, in so far as control over other companies whose securities they hold is concerned. While they do not provide a direct line of control descending from a control company through the estate to the company that the latter controls, they still create a community of interest resulting in such close coöperation that it frequently partakes of the nature of control.

Thus, the International and Great Northern Railroad Company has commonly been considered to be part of the Missouri Pacific System. The only binding link between it and the Missouri Pacific Railway Company was through the estate of Jay Gould. This estate, in 1906, was reported to own \$20,215,000 out of \$77,407,860 of the outstanding stock of the Missouri Pacific and practically all of the outstanding stock of the International and Great Northern.

Family control, according to the Federal Trade Commission's Report on the Meat-Packing Industry, is very common with Swift & Company, Morris & Company and Armour & Company. The controlling interest in these three companies is very closely held, respectively, by the Swift, Morris and Armour families. Through family interests these packers are listed as controlling nearly 50 companies, some of which are more or less unrelated to the packing business. Armour & Company controls the Armour Grain Company through a family interest of 87 per cent of that company's \$1,000,000 voting stock. And the Armour Grain Company in turn controls through stock ownership 5 other companies.

(4) *Control through fictitious persons.* In instances where the relation of control is sought to be concealed, fictitious, or non-existing persons, have sometimes been recorded on the stock books of the controlled company as the stockholders of record. Thus, the Federal Trade Com-

mission reports that the Chicago Bearing Metal Company which manufactures certain supplies for railroad use is controlled by the Swifts and affiliated interests. Among the stockholders of record were L. V. Robinson and H. B. Natches, care of C. F. Stephenson, of Swift & Company and L. R. Poor, address, Union Stock Yards, Chicago. Replies to questionnaires sent out by the Commission to these names were made by C. F. Stephenson, an employee of Edward F. Swift, who in each case attached a memorandum that there were no such persons, and stated that "Mr. Edward F. Swift is now and at all times has been the owner of this stock."⁷

It is now clear that there may appear in a single control organization a great variety of ways in which control may be established. The four modes of control with their several variations may of course be multiplied by the several distinct instrumentalities employed to institute the control. The closer the control organization comes to a direct violation of federal and state laws against monopoly and restraint of trade, the greater will be the care exercised to conceal the true condition of control.

It remains but to describe a few representative types of control companies, in order to show the great flexibility of this form of participation organization.

⁷ *Ibid*, p. 269.

CHAPTER XVII

CONTROL COMPANIES

A. TRUSTS AS CONTROL COMPANIES

PRIOR to the year 1888, when the state of New Jersey first adopted a general law giving to its corporations the power to hold the securities of other corporations, control through participation could be brought about only through the joint stock company and the trust form of organization. The holding, or combination trust, was the favorite form employed and proved itself admirably adapted to this work. Under it the parties to the Standard Oil Trust Agreement, of 1882, brought together under a single unified control the varied interests of individual proprietorships, partnerships, joint stock companies and corporations. Nowhere in the organization was the holding corporation used.

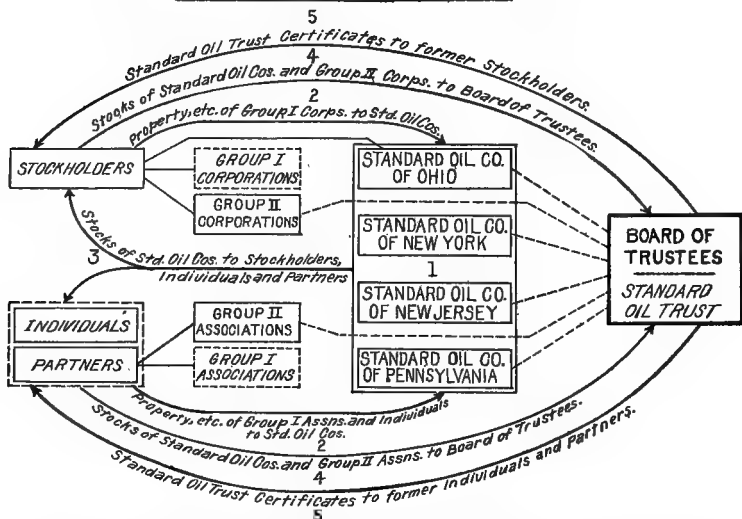
This famous trust was, however, merely a reorganization of an earlier one created by the members of the Standard Oil Group, in 1879. The conception of the idea of using the trust form for control and combination purposes has quite generally been attributed to S. C. T. Dodd, the attorney for the Standard Oil Company of Ohio.

Between the years 1880 and 1890 a number of large trusts were formed, most of them patterned after the Standard Oil Trust. In 1884, the American Cotton Oil Trust, embracing some eighty-five concerns doing business throughout the South was formed in the state of Arkansas. In 1887, the Distillers' and Cattle Feeders' Trust, the National Lead Trust and the Sugar Refineries Company were formed. These were popularly known as the "Whiskey," "Lead" and "Sugar" Trusts.

The legal principles governing trusteeship have already been explained. These apply with equal force to a simple as well as to a complex trust. However, since the trusts here under consideration involve participation in other organizations that retain their distinct entity, a few words of explanation concerning them will not be amiss.

The Standard Oil Trust of 1882.¹ — This trust because of the complexity of its organization brings out more clearly than any of the others the nature of the organization and the transactions involved in constituting it. The accompanying chart is a diagrammatic sketch of this trust.

DIAGRAM ILLUSTRATING THE TRANSACTIONS INVOLVED
IN FORMING THE STANDARD OIL TRUST OF 1882



The heavy margins indicate the units that remain after formation of the Trust and the dotted lines leading to them show control by the Board of Trustees. The assets, etc. of individuals, partners and Group I corporations and associations have been transferred to the Standard Oil Companies and the units dissolved. The figures indicate the order of transactions beginning with formation of the Standard Oil Companies.

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¹ A copy of this trust agreement will be found in Part VI of the text, pp. 560-571.

The parties to the agreement, who were the settlors of the properties upon the board of trustees, were divided into three classes, namely: (1) All stockholders and members of 14 named corporations and limited partnerships; (2) some 46 named individuals; and (3) a portion of the stockholders and members of 27 named corporations and limited partnerships.² It was then further provided that a Standard Oil Company should be formed in each of the four states of Ohio, New York, New Jersey and Pennsylvania; but the Ohio company already existed. The settlors of Classes 1 and 2 were thereupon to convey all of the property, real and personal, assets, and business mentioned and embraced in certain schedules to the Standard Oil Companies in exchange for the stocks of these companies whose par value equaled a fair valuation of the properties. The former stockholders, partners and individuals thus became stockholders of the Standard Oil Companies. They were then to turn this stock over to the board of trustees and receive in return Standard Oil Trust Certificates of equal value.

These transactions necessitated the dissolution of some of the original organizations. This was easily accomplished in the case of settlors of classes 1 and 2. However, with class 3, where the signers of the agreement comprised but part of the stockholders and partners, the entity of the organizations had to be preserved. Hence, it was provided that the stockholders and partners of this class should deposit their securities directly with the trustees. But this arrangement was changed by a supplementary agreement entered into a few days later by virtue of which the trustees were given authority to decide which companies should be dissolved and their assets absorbed by the Standard Oil Companies and which should remain under the direct control of the trustees. This latter classification

² The organizations called limited partnerships were largely special joint stock companies.

has been employed in the diagram where Group I corporations and associations represent those that were dissolved and Group II those taken over directly.

After all transactions had been completed there remained under control of the board of trustees the four Standard Oil Companies, Group II Corporations and Group II Associations, all other organizations having been dissolved.

The Whiskey Trust.—In the Distillers' and Cattle Feeders' Trust the procedure was somewhat different. Among the settlors were corporations and ordinary partnerships. In order to simplify the control it was provided that "the parties hereto who are not corporations shall become such before this deed takes effect." It is also provided that "the several corporations, parties to this agreement, shall maintain their separate organization, and each shall carry on and conduct its own business. . . . The capital stock of each corporation shall be transferred to the board (of trustees) and in lieu of the same, certificates not exceeding fifty millions of dollars, divided into five hundred thousand shares, each of one hundred dollars, shall be issued by the board and distributed as hereinafter provided."

Legal Status.—The further spread of this form of trust organization was checked through action taken by several of the states and the United States. It was at first attacked as an agreement illegal under the common law; the general contention being, that corporations committed an act *ultra vires* by giving the power of management and control over to a board of trustees. In 1887, the state of Louisiana attacked the American Cotton Oil Trust on this point. Shortly thereafter the state of New York brought suit against the North River Sugar Refining Company to force it out of the Sugar Trust, and in 1890, the state of Ohio began an action against the Standard Oil Company of

Ohio that finally resulted in the dissolution of the Standard Oil Trust.

In the Ohio case the court held,³ that, while the corporation is a separate entity from its stockholders, this fiction will be upheld only so long as a proper, harmless use is made of it; but that in the case of the Standard Oil Company, the act of the stockholders in giving the control over the corporation to the board of trustees constituted an act of the corporation and hence was null and void because such an act was beyond the power of the corporation. In the second place, it held that "its object was to establish a virtual monopoly of the business of producing petroleum, and of manufacturing, refining and dealing in it and all its products, throughout the entire country, and by which it might not merely control the production, but the price at its pleasure. All such associations are contrary to the policy of our states and void."

The second phase of the attack against trust organizations with monopolistic qualities took the form of specific legislation against trusts, pools, agreements and conspiracies in restraint of trade. Kansas passed such an act in 1889. The famous Sherman Anti-Trust Act was enacted by Congress in 1890. About the same time, Kentucky, Michigan, North Carolina and other states adopted similar legislation. By 1894, some twenty states had such laws.

Present Day Holding Trusts. — Today the combination or control trust is to be found in but a few states, notably in Massachusetts. The component elements of these trusts ordinarily are not corporations but usually joint stock companies or voluntary associations. They are to be found chiefly among the public utilities enterprises. The Central Massachusetts Light & Power Company, a trust formed in 1912, owns the entire capital stock of the Blackstone Electric Light Company, the Central Massachusetts

³ 49 Ohio St. 137; 30 N. E. 279.

Electric Company, the Union Light and Power Company and the Ware Electric Company. It serves 23 Massachusetts towns. The Central Massachusetts Power Company, 1912, and the Commonwealth Gas and Electric Companies are similar trusts. The Massachusetts Lighting Companies, also a trust, controls through ownership of securities some eighteen gas and electric lighting companies organized as voluntary associations and two corporations.

B. HOLDING CORPORATIONS AS CONTROL COMPANIES

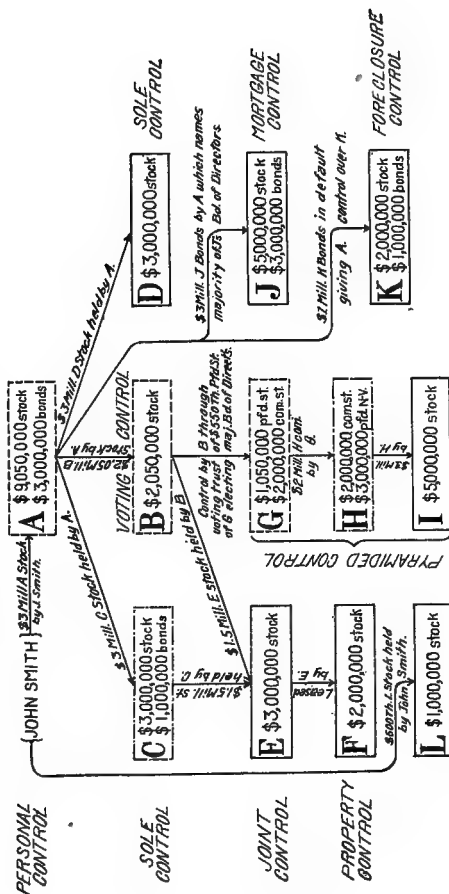
The court decisions and the legislative acts making the trust an illegal type of control organization where corporations either directly or through their stockholders became parties to it, came at the time when it was possible—at least under the laws of New Jersey,—to employ the holding corporation for the same purpose. However, its general use did not set in at once, but dates from about 1897, namely, with the beginning of the period of industrial activity following the depression which began with the panic of 1893. Since that time, the holding corporation as a control organization has become a firmly established institution; and it is today the form of ownership organization under which the great business establishments of the country are conducted. It is now quite common in such fields of business enterprise as the construction and operation of railways, street and interurban railways, gas and electric plants, most branches of manufacture with but few exceptions, in the petroleum industry, in mining, milling and smelting, meat packing, telephone and telegraph services, ocean transportation and in trade and commerce. Indeed, it may well be called the highest type of ownership organization that has yet been developed for use under a system of private enterprise.

The holding corporation is exceptionally well adapted for the institution of control over other corporations with the greatest facility. It lends itself readily to the application of the several instrumentalities of control that have been enumerated and permits of the use of the many different modes of control that have been described. Consequently, a large holding corporation need not confine itself to a single instrumentality or mode of control, but may employ a number of them in binding together the several component units of its organization. As a result of this diversification, some of our larger business organizations present a complexity and ramification that it is difficult to grasp.

In the accompanying chart is shown a hypothetical control organization built up through the use of the holding corporation and several instrumentalities and modes of control. It illustrates merely some of the possibilities that present themselves, and is not intended to depict any actual corporation. However, it is not overdrawn, since most of the methods of control there employed may be found in the Federal Trade Commission's Report on the Meat Packing Industry, published in 1919, and likewise in the special report on Intercorporate Relations Among the American Railway Companies issued by the Interstate Commerce Commission in 1908.

In order to present clearly the effect of such control organizations upon the issuance, substitution and distribution of securities, the following statement of the assets and liabilities of the twelve hypothetical corporations shown in the chart has been prepared.

CHART SHOWING TYPES OF INTER-CORPORATE CONTROL



In each instance except in the case of Company F, control is obtained through ownership of securities.

Fire Holding Companies Industrial Companies Industrial and Holding Companies.

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SUMMARIZED STATEMENT OF ASSETS AND LIABILITIES OF
COMPANIES SHOWN IN THE CHART

Company	Assets	Liabilities	
		Amount	By whom held
A	\$2,050,000 B Stock 3,000,000 C Stock 3,000,000 D Stock 3,000,000 J Bonds 1,000,000 K Bonds	\$3,000,000 Stock 6,050,000 Stock 3,000,000 Bonds	John Smith Public Public
B	1,500,000 E Stock 550,000 G Stock	2,050,000 Stock	Company A
C	1,500,000 E Stock 2,500,000 Plant	3,000,000 Stock 1,000,000 Bonds	Company A Public
D	3,000,000 Plant	3,000,000 Stock	Company A
E	3,000,000 Plant Lease of \$2,000,000 E Plant	1,500,000 Stock 1,500,000 Stock	Company C Company B
F	2,000,000 Plant (Leased to E)	2,000,000 Stock	Public
G	2,000,000 H Common Stock 1,050,000 Investments in outside concerns	550,000 Pfd. Stock 500,000 Pfd. Stock 2,000,000 Com. Stock	Company B Public Public
H	3,000,000 I Stock 2,000,000 Plant	3,000,000 Pfd. Non-Vot. 2,000,000 Com. Stock	Public Company B
I	5,000,000 Plant	3,000,000 Stock 2,000,000 Stock	Company H Public
J	8,000,000 Plant, etc.	5,000,000 Stock 3,000,000 Bonds	Public Company A
K	3,000,000 Plant	2,000,000 Stock 1,000,000 Bonds	Public Company A
L	1,000,000 Plant	600,000 Stock 400,000 Stock	John Smith Public

The value of the capital underlying the securities of this hypothetical control organization is \$30,550,000. Upon this real basic capital as supporting value a grand total of \$51,150,000 in securities consisting of \$43,150,000 of stocks and \$8,000,000 of bonds has been issued. Of the stocks the public holds \$22,950,000 and of the rest, \$16,600,000 is held by the various companies and \$3,600,000 by John Smith, while the bonds are equally distributed between the companies and the public. In all, then, the companies

hold \$20,600,000 of the securities, the public \$26,950,000 and John Smith \$3,600,000. The amount held by the companies represents the extent to which substitution of securities has been employed in effecting this centralized control. It should be noted, however, that the control of the whole organization rests in the hands of John Smith together with such other persons as own a little more than \$1,050,000 of Company A stock; and if John Smith secures the proxies of the holders of these shares, he is in a position to exercise control. The same result could be more permanently obtained if John Smith and the others created a voting trust of their majority holdings of Company A stock.

It is, therefore, apparent that control over the entire basic capital of \$30,550,000, for all practical purposes, is in the hands of John Smith, although he has invested but \$3,600,000 in the stocks of two of the companies, namely, Company A and Company L. This sum represents but one fourteenth of the total amount of securities issued and but little more than one eighth of the total basic capital. Thus, through the medium of substitution of securities and the use of the control company may the public be used to furnish industrial capital while those who promote the enterprise can, with but a relatively small investment, control a great industry.

The Control Corporation Among the American Railroads. — Practically each one of our great railway systems has at its head a control corporation. The New York Central Railroad Company holds that position in the Vanderbilt System, the Pennsylvania Company in the Pennsylvania System, the Union Pacific Railroad Company in the old Harriman System, the Southern Railway in the Morgan group and so on.

A few examples will suffice to show the use made of the holding corporation and the nature of the control by means of which these systems are held together. For this purpose

the organization of the Harriman System and of the Queen & Crescent Route will be briefly described.

The Harriman System was built up primarily by utilizing the Oregon Short Line Railroad Company, a subsidiary of the Union Pacific Railroad Company, to acquire stock control over the Southern Pacific Company, thus binding together the great Union Pacific and Southern Pacific railway systems. Somewhat later, through the Railroad Securities Company, also a subsidiary of the Union Pacific Railroad Company, the Illinois Central Railroad Company was added to the group.

In 1901, the Harriman interests made their famous "raid" on the stock of the Northern Pacific Railway Company which resulted in a struggle with the J. J. Hill and J. P. Morgan interests that was finally brought to an end by the formation of the Northern Securities Company and its subsequent dissolution by order of the United States Supreme Court. The events leading up to the formation of the latter company illustrate clearly how competition tends to bring such combinations into being.

In 1901, the Northern Pacific Railway Company and the Great Northern Railway Company began to buy control over the Chicago, Burlington and Quincy Railroad Company. They purchased the stock of this company by exchanging 20-year 4 per cent bonds to the value of \$200 for each \$100 share of stock. Within a short time they had acquired 98 per cent or \$108,000,000 of the outstanding stock for which they paid \$216,000,000. The Burlington road, however, was one of the chief feeders of the Union Pacific for its west bound traffic, and Harriman, fearing that this traffic would be diverted to the northern roads, proposed to the Hill-Morgan interests that he be permitted to secure a substantial interest in the Burlington. This proposal was rejected. He then turned his attention to securing control over the Northern Pacific Railway

Company which at that time held 49 per cent of the Burlington stock. Through the Oregon Short Line Railroad Company he soon succeeded in acquiring \$37,000,000 of the common stock and \$41,000,000 of the preferred stock of the Northern Pacific. This company had outstanding, at that time, some \$75,000,000 preferred and \$80,000,000 common, all of which was voting stock. Hill and Morgan became apprehensive of the large purchases of Northern Pacific stock and bought up the majority of the common stock. Although Harriman owned over 51 per cent of the total voting stock, he failed in his attempt to secure control of the road because its charter provided that the board of directors might redeem and retire the preferred class. This the opposing group now decided to do. But Harriman had won a point and it was agreed upon to organize the Northern Securities Company to consolidate all interests. This company was thereupon organized on November 13, 1901, with an authorized capital stock of \$400,000,000, all of one class.⁴ This stock was now exchanged for the stocks of the Northern Pacific at the rate of \$115 of Securities stock for each \$100 share of the Northern Pacific, and \$180 in the former for each \$100 share of the Great Northern. Harriman received over \$82,000,000 of the new company's stock for his holdings. In all, the Northern Securities Company thus acquired 96 per cent of the outstanding stock of the Northern Pacific and 76 per cent of that of the Great Northern.

The Northern Securities Company was at once attacked by the state of Minnesota and by the United States Government as a combination in restraint of trade because it consolidated competing lines.⁵ In 1904, the case came

⁴ A reprint of the charter of this company is given in Part VI. It is interesting because of its description of the purpose of the company.

⁵ *United States v. Northern Securities Co.*, 120 Fed., 721; *Minnesota v. Northern Securities Co.*, 123 Fed., 692.

before the United States Supreme Court which affirmed the decision of the lower court. This judgment was that the Northern Securities Company was an illegal combination in restraint of trade, and enjoined it from voting the stock of the two railroad companies that was in its possession, and the two companies from paying any dividends on their stock to the Securities Company.⁶ As a result of this decision the stockholders decided to dissolve the company and to distribute the stock that it held to its stockholders on a pro rata basis. The Harriman interests objected to this and brought suit to recover the Northern Pacific shares which they had sold to the Securities Company, but the Supreme Court sustained the pro rata plan of distribution, which was thereupon carried out.⁷

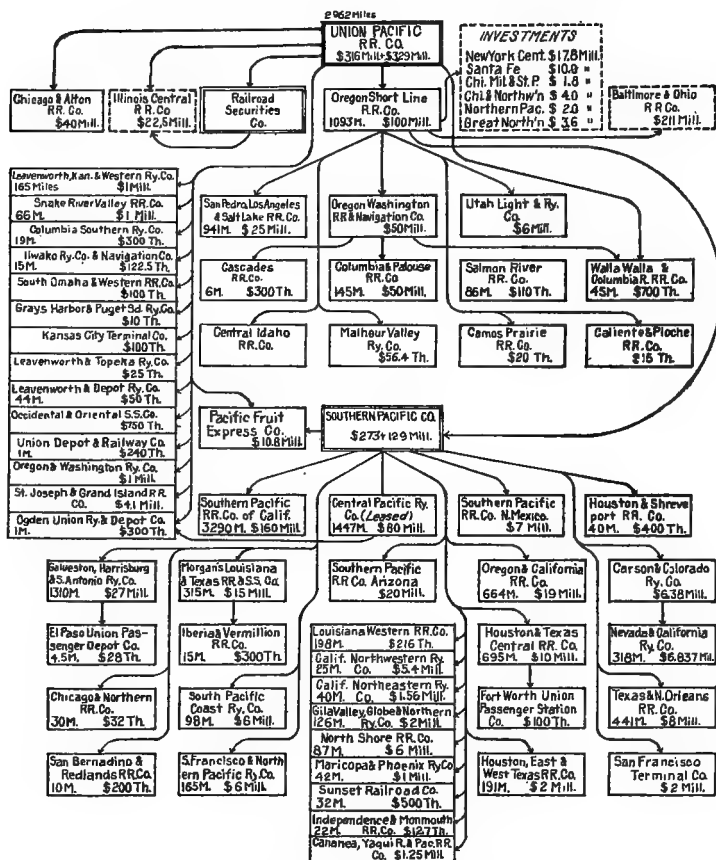
In 1912, the Union Pacific-Southern Pacific System was constituted essentially as shown in the chart in so far as railroad properties are concerned. It is to be noted that the Union Pacific Railroad Company is not only an operating but also a holding company. It not only owned and operated nearly 3,000 miles of railways, but it also controlled through stock ownership the Oregon Short Line Railroad Company and the fourteen small companies shown on the left, and in addition it controlled the Illinois Central Railroad Company and held a 27 per cent interest in the Chicago and Alton Railroad Company. Its direct holdings, however, are few and for the most part the system is held together by the Oregon Short Line Railroad Company. This company, with a capitalization of \$100,000,000 in stock and \$135,000,000 in bonds, besides owning and operating over 1,000 miles of railways, held \$126,000,000 of the stock of the Southern Pacific Company, \$50,000,000 of the stock of the Oregon-Washington Railroad & Navigation Company, \$12,500,000 of the stock of the San Pedro,

⁶ *Northern Securities Co. v. United States*, '93 U. S. 197.

⁷ *Harriman v. Northern Securities Co.*, 197 U. S. 244.

Los Angeles & Salt Lake Railroad Company and a controlling interest in seven smaller companies and had stock investments in the New York Central, Santa Fe, Chicago, and Great Northern.

RAILROAD COMPANIES OF THE HARRIMAN SYSTEM IN 1911



Milwaukee & St. Paul, Chicago & Northwestern, Northern Pacific and Great Northern aggregating \$39,200,000. Thus, this company, with its \$100,000,000 capital stock,

held nearly \$250,000,000 in the stocks of other railway companies besides its thousand miles of railways.

The Southern Pacific System also presents a peculiarity of organization that deserves a few words of explanation. At the time of the construction of the Southern Pacific Railway under C. P. Huntington, in the latter half of the decade, 1880-1890, it was found advisable to incorporate three companies under which to operate the railway mileage constructed in California, New Mexico and Arizona. These were the Southern Pacific Railroad Company of California, of New Mexico and of Arizona, respectively. Then in order to centralize control the Security-Holding Company was organized and acquired a majority of the stock of these three companies. Later on, the Southern Pacific Company, a pure holding corporation, was organized to supplant this company. The control of the Southern Pacific Company over the Central Pacific Railroad Company is through leasehold on the entire equipment of the latter. The Southern Pacific Company today owns practically the entire outstanding stock of 20 railroad companies and leases several others, all of which it operates under the name of the Southern Pacific System. In addition to this, it owns practically all of the stocks of 29 other companies, among which are a lumber company, several land development and irrigation companies, several oil exploration and pipeline companies, several city railway and power companies, several interurban electric companies and a steamship company. It also holds a stock interest in 12 other concerns including several water and land companies, the Louisiana Sugar Exchange, the Beach Hotel Company and the New Orleans Board of Trade, Limited.

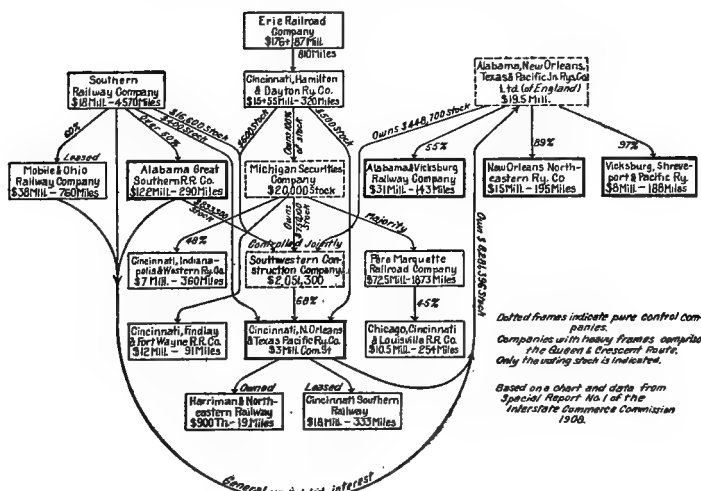
In 1912, the Supreme Court of the United States ordered the Union Pacific Railroad Company to give up its control over the Southern Pacific Company as it held this relation

to be in contravention to the Sherman Anti-Trust Act. The decree of dissolution ordered the Union Pacific Company to divest itself of the ownership of \$126,650,000 of the Southern Pacific Company's stock and to prevent this stock from falling into the hands of the stockholders of the Union Pacific. Of this stock \$38,292,000 was given to the Pennsylvania Company in exchange for \$42,647,200 of the stock of the Baltimore and Ohio Railroad Company, consisting of equal amounts of common and preferred stock. The other \$88,357,600 of Southern Pacific stock was turned over to the Central Trust Company of New York which issued trust certificates for that amount to the Union Pacific Company. It was also ordered that these trust certificates should be sold to persons other than Union Pacific stockholders by September 2, 1913. These transactions were not finally completed until December 31, 1915, when the Union Pacific directors reported a net profit of \$16,099,190 from the sale and disposal of the company's Southern Pacific holdings. In 1914, all but \$3,594,035 common and \$1,805,992 preferred stock of the Baltimore and Ohio Railroad Company was distributed as a property dividend to the Union Pacific stockholders. In this way was the centralized control binding these two great systems together broken, and today they operate as competing lines.

Although most of our larger railway systems have been formed by means of the simple control relations that exist in the Union Pacific and Southern Pacific Systems, this by no means is without exceptions. For example in the Queen and Crescent Route this high degree of centralization of control is conspicuously absent. That system, as will be seen from the accompanying chart illustrating its organization as it was in 1905, was held together not through a single control corporation, but through the interrelation by majority and minority holdings of voting stock by three more or less independent, or at least uncontrolled

companies. The system made liberal use of pure holding corporations. Of these the most prominent was the Michigan Securities Company, a corporation that had but \$20,000 of capital stock but that held a controlling interest in the Père Marquette Railroad Company with its \$72,500,000 of voting stock, a 48 per cent interest in the Cincinnati, Indianapolis and Western Railway Company with its \$7,000,000 of voting stock, a large share of the \$12,000,000

INTERCORPORATE RELATIONS OF THE QUEEN AND CRESCENT ROUTE
ABOUT 1906



voting stock of the Cincinnati, Findlay and Fort Wayne Railroad Company and in addition a three-eighths interest in the Southwestern Construction Company with \$2,051,300 voting stock, and that in turn controlled the Cincinnati, New Orleans and Texas Pacific Railway Company. Thus this holding company partakes of the character of a pure "dummy" organization and may be likened to the dummy stockholders previously described.

The system has since undergone numerous changes. The

Père Marquette has been lopped off, and the Cincinnati Hamilton and Dayton at one time came under the control of the Harriman interests.

Control Corporations among Public Utilities. — In the field of public utilities, which includes water, gas and electric works, street railways and telephone and telegraph enterprises, the holding control corporation is but little less important than among our railroads.

In this field we find the splendid example of the Interborough-Metropolitan Company that at one time controlled through direct ownership of stock the New York Railways Company, the Metropolitan Securities Company and the Interborough Rapid Transit Company, and indirectly through these three some seventeen other companies, all operating street railways in and about New York City.

The American Telephone and Telegraph Company, also operating a public utility, is even more widely known than the New York Street Railways combination. This company was incorporated under laws of the state of New York, in 1885, primarily to construct and operate long distance telephone lines for the American Bell Telephone Company which owned all of its capital stock. In 1900, the charter was amended so as to increase its capitalization and it thereupon acquired by substitution of securities all of the capital stock of the American Bell Company by giving the stockholders of the latter two of its shares for every one of the Bell Company shares surrendered to it. The American Bell Telephone Company was subsequently dissolved and the American Telephone & Telegraph Company assumed its place as head of the great telephone system which today owns and controls about 70 per cent of the telephone stations and equipment of the country.

Through a monopoly of the famous Bell patents it is in full control of the so-called Bell System. In this system

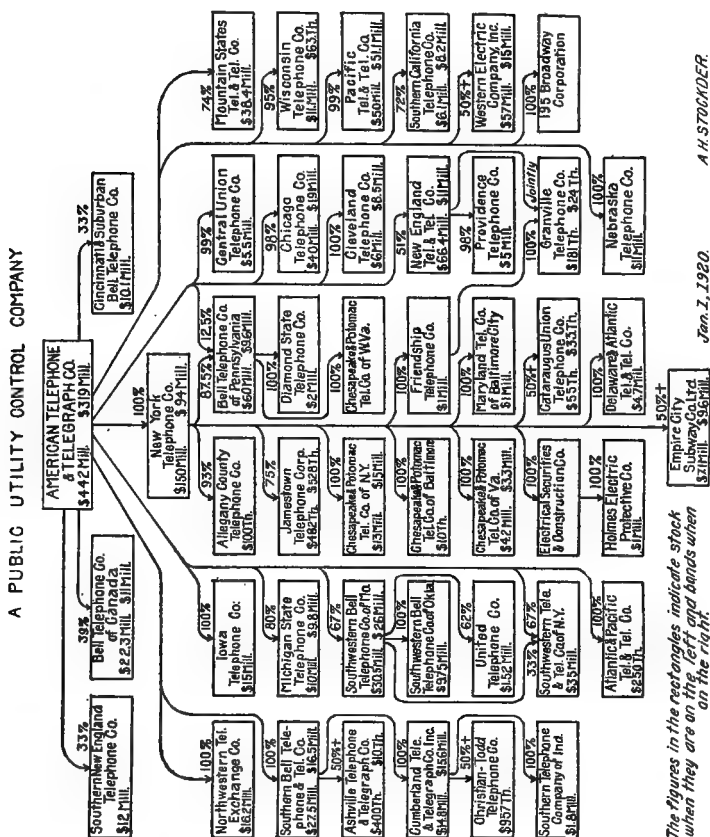
are the companies directly controlled by the American Telephone & Telegraph Company through stock ownership and the *Associated Bell Companies*. The latter operate under an arrangement whereby the American Company furnishes all needed telephones, replaces them with others when necessary, grants the right to use all patents owned and controlled by it and administers a centralized control over the entire system. In return for these services, the associated companies pay to the American Company $4\frac{1}{2}$ per cent of their annual gross telephone receipts.

In 1911, the American Telephone & Telegraph Company acquired the entire capital stock of the Western Telephone & Telegraph Company which was dissolved. At about the same time it gained control over the Western Union Telegraph Company but was forced soon after to relinquish its holdings in this concern as the relation was held to be in violation of the Sherman Act.

Beside operating its own lines, this company, in 1919, controlled through direct and indirect stock ownership some 35 telephone and telegraph companies. It owned also 97 per cent of the entire capital stock of the Western Electric Company, Inc., whose chief business it is to manufacture the apparatus used in the Bell System, the entire capital stock of the 195 Broadway Corporation which owns the great building housing the main offices of the company in New York City, and the entire stock of the Electrical Securities & Construction Company that installs and operates electrical protective devices and of the Empire City Subway Company, Limited, that constructs underground telephone conduits. The capitalization of the parent company consisted of \$441,981,200 in stock, \$229,403,600 in bonds and \$90,000,000 in coupon notes. Thus, the whole organization had issued altogether well over one billion dollars in securities.

The chart, based on available public information, illustrates merely the essential features of the organization. It

omits a number of subsidiaries, such as the Southern New England Telephone Company, the Bell Telephone Company



of Canada and the Cincinnati & Suburban Bell Telephone Company.

Control Corporations among Industrials.—Our industrial control corporations exhibit comparatively simple lines of control through stock ownership. In this respect they resemble quite generally the type exemplified by the

American Telephone and Telegraph organization. As a rule they acquire the ownership of all of the outstanding stock of their subsidiaries with the exception of such shares as are necessary to qualify the directors of these corporations under their respective corporation laws. They thus partake of the character of incomplete mergers and amalgamations. They retain the corporate entity of the subsidiary chiefly because it serves to set aside definite pieces of property that can be more easily used to support bond issues. If the subsidiaries were dissolved it would most likely place the head corporation under the necessity of successively hypothecating its collective property when expansions were to be undertaken.

For the same reason industrial as well as other control companies usually cause subsidiaries, all of whose stock the parent retains, to be incorporated for the purpose of constructing and operating new plants. Then, as the work progresses, bonds are issued to the public in order to secure the necessary capital. Such was the expedient adopted by the United States Steel Corporation when, in 1906, it caused the Indiana Steel Company to be incorporated to undertake the construction and operation of the great steel plant at Gary, Indiana; and likewise when some years later it formed the Federal Shipbuilding Company to construct and operate a shipbuilding plant at Newark, New Jersey.

However, industrial holding corporations also frequently consolidate two or more of their subsidiaries through mergers and amalgamations. Consolidations of this type are usually undertaken for the purpose of centralizing the administration of plants within a given geographical area or locality or in order to centralize control over a number of subsidiaries engaged in the same kind of undertaking. Here again the United States Steel Corporation furnishes some excellent examples. Thus, in 1903, the American Steel Hoop Company, the National Steel Company and the

Carnegie Company were amalgamated into the Carnegie Steel Company placing under a single management most of the United States Steel Company's plants in the Pittsburgh and adjacent Ohio districts. At the same time the American Coke Company, the Continental Coke Company, the H. C. Frick Coke Company, and McClure Coke Company, the Southwest Connellsville Coke Company and the United Coal and Coke Company were all merged into the H. C. Frick Coke Company.

A brief description of the control organization of the Standard Oil Company of New Jersey and the United States Steel Corporation will serve to show the simple form of stock ownership control used by industrials.

The Standard Oil Company of New Jersey was first incorporated in 1882 in compliance with the Standard Oil Trust Agreement of that year. In 1890, the Supreme Court of the state of Ohio declared the trust agreement to be void. However, the dissolution of the trust was not carried out expeditiously and it was not until 1899 that it may be said to have been completed. In that year the charter of the Standard Oil Company of New Jersey was amended to enable the company among other things "to purchase or otherwise acquire, hold, sell, assign, and transfer shares of capital stock and bonds or other evidences of indebtedness of corporations, and to exercise all the privileges of ownership, including voting upon the stock so held." At the same time the capital stock of the company — which since March 19, 1892, had been \$10,000,000 — was increased to \$110,000,000. The purpose of this move was essentially to reconstitute the lines of control established through the old trust organization by substituting in its place a holding corporation. Practically all of the corporations and associations that had been parties to the trust were thereupon acquired through stock ownership control within a short period of time. But the process of ex-

Name of Company	Total capital stock	Owned by Standard Oil Company
1. Anglo-American Oil Co., Ltd.	£1,000,000	£999,740
2. Atlantic Refining Company	\$5,000,000	\$5,000,000
3. Buckeye Pipe Line Company	10,000,000	9,999,700
4. Chesebrough Manufacturing Co., Consol.	500,000	277,700
5. Colonial Oil Company	250,000	249,300
6. Continental Oil Company	300,000	300,000
7. Crescent Pipe Line Company	3,000,000	3,000,000
8. Eureka Pipe Line Company	5,000,000	4,999,400
9. Galena-Signal Oil Co.	10,000,000	7,079,500
10. Indiana Pipe Line Company	1,000,000	999,700
11. Lawrence Natural Gas Company	450,000	450,000
12. Mahoning Gas Fuel Company	150,000	149,900
13. Mountain State Gas Company	500,000	500,000
14. National Transit Company	25,455,200	25,451,650
15. New York Transit Company	5,000,000	5,000,000
16. Northern Pipe Line Company	4,000,000	4,000,000
17. Northwestern Ohio Natural Gas Company	2,775,250	1,649,450
18. Ohio Oil Company	10,000,000	9,999,850
19. People's Natural Gas Company	1,000,000	1,000,000
20. Pittsburg Natural Gas Company	310,000	310,000
21. Solar Refining Company	500,000	499,400
22. Southern Pipe Line Company	10,000,000	10,000,000
23. South Penn Oil Company	2,500,000	2,500,000
24. Southwest Pennsylvania Pipe Lines	3,500,000	3,500,000
25. Standard Oil Company (California)	17,000,000	16,999,500
26. Standard Oil Company (Indiana)	1,000,000	1,000,000
27. Standard Oil Company (Iowa)	1,000,000	1,000,000
28. Standard Oil Company (Kansas)	1,000,000	999,300
29. Standard Oil Company (Kentucky)	1,000,000	997,200
30. Standard Oil Company (Nebraska)	600,000	599,500
31. Standard Oil Company (New York)	15,000,000	15,000,000
32. Standard Oil Company (Ohio)	3,500,000	3,499,400
33. Swan and Finch Company	100,000	100,000
34. Union Tank Line Company	3,500,000	3,499,400
35. Vacuum Oil Company	2,500,000	2,500,000
36. Washington Oil Company	100,000	71,480
37. Waters-Pierce Oil Company	400,000	274,700

tension of control was not halted until the United States Government, in 1910, brought suit in the Circuit Court of the United States for the Eastern District of Missouri for the dissolution of the combination. The case was taken on appeal by the defendants to the United States Supreme Court, which, in 1911, upheld the decision of the lower court and ordered the Standard Oil Company of New Jersey to disposses itself of the stocks of most of its controlled companies and to refrain from again establishing any form of control over them that might be in restraint of competition.⁸

At the time of this decree of dissolution, the Standard Oil Company held a stock control over some forty corporations and a minority interest in two other corporations. Of these, thirty-seven were controlled directly by the Standard Oil Company of New Jersey as shown on the opposite page.

Participation in the other five was instituted through the medium of the National Transit Company which held a controlling interest in three of them and a minority interest in two.

The United States Steel Corporation is a pure industrial control company whose general features of organization are strikingly similar to those of the old Standard Oil Company, just described. It was formed in 1901, in New Jersey, with an authorized capital stock of \$1,100,000,000 made up of equal amounts of common and preferred stock.

⁸ *Standard Oil Co. v. United States*, 221 U. S., 1.

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Under the plan of promotion the corporation was to acquire, by means of the substitution of securities, the entire outstanding stock of the following eleven companies:

	Common Stock	Preferred Stock	Total
1. Federal Steel Company...	\$46,484,300	\$53,260,900	\$99,745,200
2. National Tube Company..	40,000,000	40,000,000	80,000,000
3. American Steel & Wire Company.....	50,000,000	40,000,000	90,000,000
4. National Steel Company..	32,000,000	27,000,000	59,000,000
5. American Tin Plate Com- pany.....	28,000,000	18,350,000	46,350,000
6. American Steel Hoop Company.....	19,000,000	14,000,000	33,000,000
7. American Sheet Steel Company.....	24,500,000	24,500,000	49,000,000
8. Lake Superior Consoli- dated Iron Mines Com- pany.....	29,425,940		29,425,940
9. Shelby Steel Tube Com- pany.....	8,151,500	5,000,000	13,151,500
10. American Bridge Company	30,527,800	30,527,800	61,055,600
11. The Carnegie Company..	160,000,000		160,000,000
	\$467,989,540	\$252,638,700	\$720,628,240

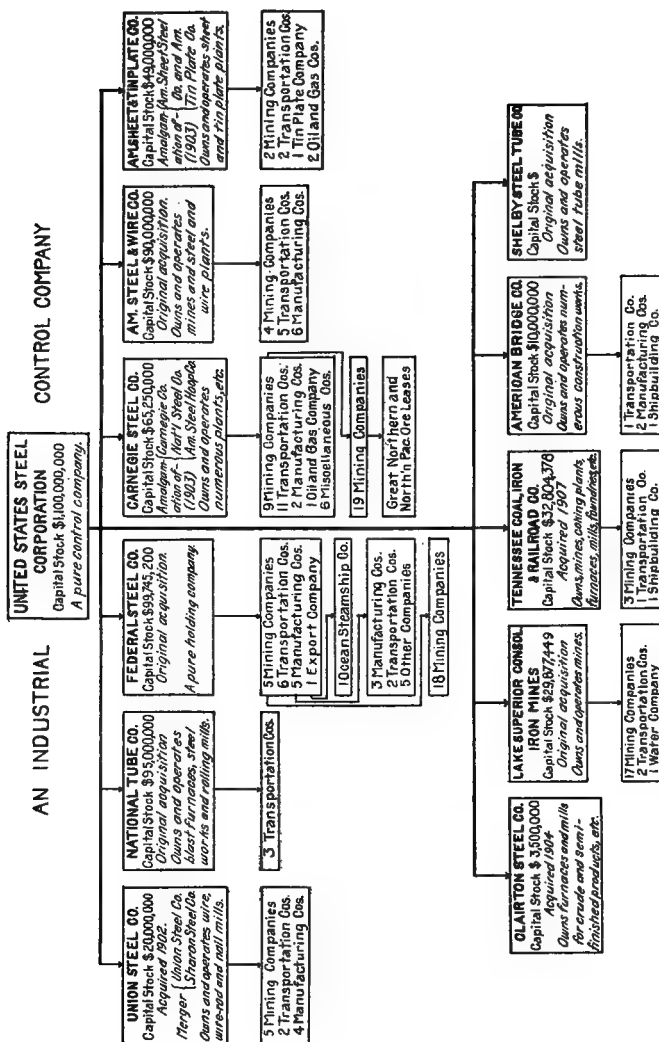
To acquire these securities the United States Steel Corporation issued \$508,227,394 in common stock, \$510,205,743 in preferred stock, \$303,450,000 in bonds and assumed \$80,963,680 in the outstanding bonds of these companies, a total of \$1,402,846,817 in securities.

With the exception of the Shelby Steel Tube Company each of the eleven companies taken over by the Steel Corporation was itself a holding company that controlled numerous subsidiaries. In the aggregate these were well over one hundred in number. In 1902, the corporation acquired the \$20,000,000 of outstanding capital stock of the Union Steel Company; in 1903, the mergers and amalgamations of subsidiaries previously described were

effected; in 1904, the Clairton Steel Company was taken over and in 1907, the corporation bought nearly the entire outstanding capital stock of the Tennessee Coal, Iron and Railroad Company. In addition to these acquisitions the Steel Corporation has caused several large corporations to be organized from time to time to undertake the construction and operation of new plants. Among these are the Indiana Steel Company and the Universal Portland Cement Company, in 1906, the Federal Shipbuilding Company, in 1917, the Chickasaw Shipbuilding Company, in 1918, and many others.

The accompanying chart shows the organization of the Steel Corporation as of 1919, as nearly as this can be ascertained. In that year it controlled through its eleven primary subsidiaries over 160 different companies. Among the large units only one, the Federal Steel Company, is a pure holding company, while all of the others own in fee and operate plants and equipment of one type or another. In but very few instances are subsidiaries controlled through the ownership of less than practically the entire amount of outstanding capital stock. Among the exceptions are the Pewabic Company, controlled through the ownership of 50 per cent of the capital stock, the Pittsburgh, Bessemer & Lake Erie Railroad controlled through a 52.2 per cent stock ownership, the Pennsylvania & Lake Erie Dock Company through 78 per cent stock ownership and the Pittsburgh Limestone Company.

While industrial control companies are ordinarily quite simple and confine their holdings very largely to business undertakings within a given industry, there are, nevertheless, conspicuous exceptions to this general rule. In this class are the five great American Packing Companies, namely, Swift & Company, Armour & Company, the Cudahy Packing Company, Morris & Company and Wilson & Company, Inc. They are interested individually and



This chart shows the 11 major subsidiaries and indicates the number and kind of companies controlled by each in 1919 as fully as this could be ascertained.

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jointly in banks, public utilities, railroads, cotton oil companies, publications and numerous other concerns whose activities are technically not pertinent to the packing industry.

The varied interests of E. I. du Pont de Nemours & Company present a similar situation. This company was organized primarily for the purpose of manufacturing powder, explosives and constituent and derivative chemicals. In 1920 it controlled directly besides several powder and chemical companies, a building and construction company, a moving picture theater company, a varnish works, a hotel company, an engineering concern and an investment company. Through the latter company, which is the Du Pont American Industries, Inc., the parent concern controls three other securities companies, one of which owns 38 per cent of the outstanding stock of the General Motors Corporation. This company in turn owns practically the entire outstanding capital stock of 46 companies engaged in the manufacture of automobiles, parts, accessories, etc., and has a large interest in 27 other companies.

The Control Company in Ocean Transportation. — The International Mercantile Marine Company today occupies the same position in the field of ocean transportation of the world that the United States Steel Corporation occupies in the iron and steel industry of the United States. This corporation is noteworthy because it controls companies chartered in four different countries, namely, the United States, Canada, the United Kingdom and Belgium. The company itself was incorporated in New Jersey in 1893 as the International Navigation Company. This charter was amended in 1902 and the name changed to International Mercantile Marine Company. At the same time, the authorized capital stock was increased to \$120,000,000 made up of equal parts of common and 6 per cent cumulative preferred stock. The company then acquired a

The majority of the voting stock was originally held by a voting trust. This, however, terminated in 1915, when the company was forced into temporary receivership because of default in the interest of its mortgage and collateral trust bonds. By the middle of 1916 the bondholders' claims had been adjusted and control reverted to the stockholders. In the same year the company together with the American International Corporation, W. R. Grace & Company and the Pacific Mail Steamship Company purchased the entire plant and assets of the New York Shipbuilding Company. The several interested companies then caused the New York Shipbuilding Corporation to be formed and transferred to it the properties which had been acquired. The four companies work under an agreement whereby the tonnage constructed by their shipbuilding corporation is apportioned among them and is paid for on a cost-plus-a-percentage plan. The Mercantile Marine Company also owns the office building at Number 1 Broadway in New York City, which is managed through a subsidiary.

A similar organization — financially less important, but more extensive in the number of companies controlled — is the Atlantic, Gulf and West Indies Steamship Lines. This company was incorporated in Maine, in 1908, and took over certain properties of a defunct corporation. Subsequently it acquired practically the entire outstanding stock of some nineteen steamship and wharf companies operating along the Atlantic coast and in the Gulf of Mexico, including several oil producing companies in Mexico. But few of its subsidiaries are alien corporations.

Mercantile Control Companies. — In the mercantile field various attempts have been made to build up extensive retail stores organizations through the medium of the control company. The early attempts in this direction were failures. This was notably the case with the old H. B.

Claflin & Company, a corporation which stood at the head of a combination of department stores. However, there are today several control companies that are operating successfully in this general field. Most of them are of recent formation.

The American Druggists' Syndicate incorporated in 1910, in New York, now controls some ten active and six inactive corporations through ownership of practically all of their outstanding stock. The United Drug Company, organized in Massachusetts, in 1916, with an authorized capital of \$65,000,000 controlled, in 1920, some fifteen corporations with a total authorized capital stock of \$31,584,000.

A somewhat more recent mercantile control corporation is the United Retail Stores Corporation, formed in Delaware in 1919, with an authorized capital consisting of 160,000 founders' shares of no par value, 1,000,000 shares of class "A" common stock of no par value and \$10,000,000 eight per cent accumulative preferred stock. This corporation controls the United Cigar Stores Company of America, the U. R. S. Candy Stores, Inc., Fuerst & Kraemer Company, Gilmers Inc., and Montgomery Ward & Company, Inc.

In the dry goods trades there are also several such organizations. Among these may be mentioned the Associated Dry Goods Corporation, incorporated in Virginia in 1916, that controls some fourteen other companies, and the Mercantile Stores Company, Inc., formed in Delaware, in 1919, as a reorganization of the Mercantile Stores Corporation whose properties consisted chiefly of all, or of the major part, of the outstanding stocks of some twenty-four dry goods and manufacturing companies.

The Control Company in Other Countries.—The control company is characteristically American and has not come into general use in Europe. A few are to be found in

England, France, Germany, Holland and Switzerland, but even many of these are developments of American enterprises. The reason for this condition may very largely be attributed to the use of other instrumentalities of combination such as trusts and kartells which are generally illegal in the United States. Through these a partial control can be exercised. If complete control is desired, this may be obtained through consolidation or outright absorption. Among the larger European concerns that may properly be called control companies are the *Allegemeine Electrizitätsgesellschaft* (General Electric Company of Germany), the *Schaaffhausenscher Bankverein* (a German potash combination), the *Swiss Aktiengesellschaft für Unternehmungen der Textilindustrie*, the *De Beers Consolidated Mines, Limited* and the *Car Trust Realization Company*,⁹ of England, the *Compagnie générale d'Electricité*, of France, and the *Compagnie générale des Nitrates*, of Belgium.

As a result of the industrial breakdown arising out of the war, there is now in evidence a general movement, that is especially strong in the central European countries, toward a more extensive use of this type of ownership organization. Nevertheless, it is doubtful whether this type of company will attain there the pre-eminent position that it holds in the United States.

Advantages and Weaknesses of the Control Company. — The reason for the very extensive use of the control company in the United States for purposes of business ownership is found to lie in the inherent advantages that this form of organization offers. These may not, however, be considered abstractly, for they are but the reflection of the background of the economic, political and judicial structure of the United States. To this background do they owe their existence. Were it to be altered, it might deprive

⁹ The Car Trust Realization Company is a joint stock company.

them of certain advantages that they now possess, or even do away with them entirely. With this point in mind, we may turn to a consideration of some of the more prominent advantages.

(1) The holding company is admirably adapted to the formation of horizontal as well as vertical combinations. In this particular it differs materially from the federation organizations such as the pool, the kartell and the syndicate. It is hardly necessary to dwell upon this feature. We have seen from the examples given that most of our larger control companies link together long chains of like as well as unlike companies. While the American Telephone and Telegraph Company, the International Mercantile Marine Company, the United Retail Stores Company and others are characteristically horizontal combinations, they, nevertheless, have also reached backward or forward to include in their organizations concerns operating in preceding or succeeding stages of industrial activity. Thus we find the Western Electric Company, the Empire City Subway Company and the 195 Broadway Corporation among the controlled companies of the American Telephone and Telegraph Company, and the New York Shipbuilding Company jointly controlled by the International Mercantile Marine Company and others. On the other hand, it requires but a cursory inspection of the chart depicting the organization of the United States Steel Corporation in order to enable one to grasp the extent to which not only integration but also horizontal combination has been effected through the medium of the control company. Here we find controlled companies that respectively produce the coal, the iron ore, the limestone, that operate blast furnaces, steel converters, rolling mills and plants for the manufacture of finished products; that operate railways, docks and steamers, and even the United States Steel Products Company, which handles the export

trade of all of that corporation's subsidiaries. Due to the facility with which combination in either direction may be carried out, the control company has unlimited possibilities in the direction of monopoly, a fact that is well attested by the numerous cases that have been brought before our courts under the Sherman Anti-Trust Act seeking to force a dissolution of these combinations.

(2) It lends itself readily to centralization of control along functional or technological lines. We saw, for example, in the reorganizations effected within the United States Steel Corporation, how this company used the H. C. Frick Coal & Coke Company to centralize control over its coal mining and coke manufacturing subsidiaries, how most of its iron mines are under the control of the Lake Superior Consolidated Iron Mines and how its manufacturing plants, railroads, steamship companies, etc., are controlled through separate corporations. The organizations created by the five great packers also furnish us with many fine illustrations of this practice. Its advantage lies in the opportunity that it affords for the development of specialists in the several functions and for the advancement of technique in production.

(3) It fits ideally into the scheme of multiplicity of legislative jurisdictions which is such a prominent feature of our political organization. The direct ownership by a single corporation of business establishments scattered throughout several states is objectionable. In all but one of those states it must needs be a foreign corporation, and in each one, it is subject to special laws governing its entry for business purposes. It is there discriminated against in favor of domestic corporations. To avoid these difficulties, the control company has been successfully employed. The Southern Pacific Railroad System was organized with this point in mind, as its California, Arizona, New Mexico and Texas subsidiaries will testify. The

American Telephone and Telegraph Company, the Cities Service Company, the General Electric Company and hosts of others also take cognizance of this fact.

(4) It is usually in a position to take advantage of its competitors in marketing its product. This advantage tends to be greatest when the control company has attained a commanding position in that field of industry in which it operates. It may then organize "bogus independent concerns" like those used by the E. I. du Pont de Nemours Company, the American Tobacco Company, the National Cash Register Company, the International Harvester Company and numerous others. But quite aside from this feature, large scale production and monopolistic or semi-monopolistic position in the industry, so common among our larger holding companies, put them in command of many forms of unfair competition that smaller concerns cannot use with a like degree of success.¹⁰ In fact, so common has the use of unfair methods of competition by control companies become that certain sections of the Clayton Amendment to the Sherman Anti-Trust Act, passed in 1914, aim directly at their suppression.

(5) Financial advantages also are outstanding features of this form of organization. There is inherent in the control company the device that is known as making the enterprise pay its own purchase price. Thus, when in 1913, the United Drug Company decided to go into the cigar business in competition against the United Cigar Stores Company, the latter countered by going into the drug business. It purchased control of the Riker & Hegeman Company for \$3,000,000. Thereupon, it organized a new company under the laws of the state of Delaware to which it turned over the control of the Riker & Hegeman Company. It retained 52 per cent of the stock of this new company and sold the rest, which netted it some \$2,400,000. In this way

¹⁰ See W. H. S. Stevens, *Unfair Competition*.

the control that it originally purchased for \$3,000,000 cost it but \$600,000. Similar methods were employed in organizing the United States Shipbuilding Company and the Corn Products Company.¹¹ Another financial advantage comes out of the fact that, by proper selection of classes of securities coupled with the use of pyramided control, it is possible for a few financiers to command enormous amounts of invested capital. This was well illustrated by such examples as the Rock Island Company and the Atlantic Coast Line, discussed above.

(6) The ease with which combinations bound together through a control company may be dissolved may also, under certain circumstances, prove to be an advantage. Many of our larger combinations have been declared by the courts to be in violation of anti-trust statutes and have been ordered to dissolve. Had they been organized on the principle of fusion it might have meant considerable loss to them. However, under the control form of organization the sale of part of the securities held was sufficient to comply with the court's orders. This method of dissolution as frequently as not proves to be a profitable venture for the stockholders of the dissolved concern. At least such was the result in the case of the sale of the Southern Pacific stock by the Union Pacific Railroad Company. This form of organization consequently injects a high degree of vendibility into invested capital which under present day industrial conditions appears to be one of the fundamental requirements of a good ownership organization.

Weaknesses of the Control Company.—The advantages of the control company are in part offset by certain weaknesses. In general, these are of two types, first those that pertain directly to the administration of the enterprise and second, those that affect the investor adversely.

¹¹ For an account of these promotions see Dewing, *Corporate Promotions and Reorganizations*.

(1) The administrative weaknesses arise out of the principle of legal entity which applies to all of the controlled companies. Each one of these companies must run its own business; it must elect its own officers and directors, keep its own accounts, make its own reports, pay its own taxes, etc. To be sure, much of it is ordinarily reduced to a minimum and is carried on perfunctorily merely to meet the requirements of the law. But even so, in a large control company that has many subsidiaries, this duplication of administrative details must necessarily increase the operating expenses.

(2) From the standpoint of the investor, the control company's greatest defect is the difficulty of ascertaining the value supporting its securities. We have already seen how the practice of over-capitalization has brought about a condition that has reduced the outstanding securities, at their par value, to nothing more or less than a pure fiction. If the investor is to formulate any judgment as to the soundness of the enterprise he must necessarily investigate the condition of each of the controlled subsidiaries. This of itself would be an enormous task, even if he could secure complete reports of their financial standing, which, however, is usually impossible. Then too, the dispersion of holdings among a vast multitude of stockholders makes it very easy for a few large stockholders, or a voting trust, to gain control over the company although they may own but a minority of its stocks. The multiplicity of securities also tends to bring about a lack of unity of interest in the body of security-holders. The interest of the bondholders, preferred stockholders, and common stockholders are frequently diametrically opposed on many points, with the result that each group is continually fighting the others to better its position.

But after all, it is not so much the structural weaknesses that have brought our great control companies into such

bad repute as it is the laxness of the laws under which they have been formed that permit of financial manipulation, the tendency toward the establishment of a monopolistic position in industry, and the use by them of many questionable and unfair practices through which they seek to break down competition.

CHAPTER XVIII

FINANCE AND ASSUMPTION COMPANIES

THE legal requirements governing the formation of securities-issuing companies, as well as the peculiar economic conditions with respect to promoting and financing that are to be found in certain industries, are very largely responsible for the existence of the so-called finance companies and the closely related assumption companies.

Promotion.—In the broadest sense of the term, promotion is comprised of the following steps:

- (1) First, the idea for the new undertaking must be weighed in the balance and its feasibility investigated and determined.
- (2) Next the enterprise must be assembled; namely, options must be secured on such properties, patents, rights, etc., as it is thought desirable to include in the undertaking.
- (3) Then arrangements must be made whereby the securities may be issued in exchange for capital in the form of cash or credit wherewith to acquire the properties that are to be taken over.
- (4) And in the meantime, the legal steps of obtaining a charter and of providing an administrative organization for the corporation must be attended to.

Of all these, it is usually the third step that presents the greatest obstacle to the successful promotion of a large corporate business enterprise. In a small enterprise, those who undertake it usually subscribe all of the capital that is necessary. However, in a large enterprise, whose capi-

tal requirements run into millions of dollars, special arrangements must be made with persons or companies that have sufficient ready cash available, or are in a position to borrow it, to supply the corporation's need of funds. This may be done in two ways—(1) the securities may be offered for subscription directly or through jobbers and brokers to the public, or (2) they may be turned over in large blocks to underwriting syndicates or finance companies. In the latter case, the company is being *financed*.

What Constitutes Financing a Company.—The work of the underwriting syndicate may be divided into two sets of transactions. In the first place, it contracts with the corporation or the promoters to furnish a definite sum of money within a definite time limit in exchange for the securities that it underwrites. It thus agrees to supply all, or at least a large part, of the investment capital necessary to establish the enterprise. In the second place, the syndicate seeks to sell the underwritten securities to the public in order to secure new funds for further operations. In this transaction it may either make a profit by selling at a higher price per share than it gave for the securities, or lose heavily if the public does not buy. Ordinarily the syndicate can complete its work and recover its funds from the public within a relatively short period of time, but frequently the securities must be held by it for years or until the corporation shows some tangible prospects of success.

In practically all English-speaking countries underwriting, to the exclusion of nearly all others, has become practically the only method now generally employed in promoting the larger enterprises. For this reason, the term "financing the enterprise" has been construed to include both of the transactions described above. However, since modern organizing ability has succeeded in developing specialized companies that confine their activities essentially to one or the other of them, it will be necessary

to differentiate. Consequently, for the purpose of this chapter, the term financing connotes the supplying of capital in the form of investable funds in exchange for securities, while the process of throwing off the securities acquired through financing transactions will be referred to as emission of securities. And correspondingly we have finance organizations to do the financing and securities-assumption companies to assist them by relieving them of the securities acquired through finance operations.

General Finance and Assumption Companies.— Under modern conditions financing is done by four agencies, namely, (1) by banks and trust-companies, (2) by industrial corporations, (3) by special finance companies, and (4) by the state. The latter need not be considered.

Not all banks participate in finance operations. It is a risky business, and in order to protect depositors our federal reserve and state banks are, for the most part, prohibited by law from engaging in it. In the United States, therefore, the trust companies and the private banking associations perform this work by becoming members of underwriting syndicates. Over-participation in such ventures has been the direct cause of the failure of several large trust companies, notably of the Knickerbocker Trust Company, the Trust Company of the Republic and the Merchants Trust Company of New York. These found themselves in a position in which their funds were so tied up in securities upon which they could not realize that they were unable to meet the withdrawal demands of their depositors.

In England, immediately after the passage of the Limited Liability Act of 1862, a great number of the so-called "financial companies" sprang up. These companies usually accepted deposits or loans and conducted their finance operations with borrowed funds. At first they assisted in the reorganization of joint stock companies,

partnerships and individual proprietorships into corporations with limited liability and at a later period financed many of the trust companies and investment companies. In France, the famous *Crédit Mobilier* seems to have been the forerunner of this type of institution which is at the present time represented there by the “*banques de credit*” and the “*banques d'affaires*” that exist in considerable numbers. In Germany, they have their counterpart in the “*Effektenemissionsbanken*,” also called “*Emissionsbanken*.”

These institutions differ from the true finance company in that they work very largely with the funds of their depositors and not, as do the latter, with their own funds. In most cases they appear not to have been very successful in their finance undertakings. Many have gone out of business altogether, others have become investment companies and still others deposit and trust companies.

Industrial corporations frequently are strong enough financially to finance their newly created subsidiaries without having to resort to outside agencies. Thus, when in 1906, the United States Steel Corporation decided to erect the great steel plant at Gary, Indiana, it organized the Indiana Steel Company with an authorized capital stock of \$50,000,000 and financed the undertaking to a large extent out of its own earnings, for only about \$20,000,000 of outside capital was secured through bond issues. This practice is also extremely common among the electrical equipment manufacturing concerns and those that construct gas works, water works and street railways, etc. The same thing is true of land development, exploration, mining and tropical exploitation companies.

Special Finance and Assumption Companies. — The *special finance companies* are those that have been created especially for the purpose of financing other companies. They are usually more or less permanent and in this respect

differ radically from the underwriting syndicates which are temporary and confine their operations ordinarily to a single venture. They may be classified in two ways, that is to say: (1) they may undertake general finance operations without reference to lines of industrial demarkation or they may specialize in enterprises of a particular industry and (2) they may themselves be independent companies or subsidiaries of banks or industrials, formed to finance other subsidiaries founded by the parent company.¹

In order to be successful, a finance company must have some means of throwing off the securities that it has acquired through its operations in order to obtain new capital to continue its financing; otherwise it will become merely an investment company after its original capital is exhausted. The company may, of course, attempt to sell the securities it holds to investors. But there is a practical difficulty militating against this procedure; this is the fact that most of the enterprises that have been financed frequently do not begin to show profits for some years immediately following their formation. Hence, these securities, ordinarily, must be sold, if at all, at a loss. To avoid this, the finance companies usually resort to the practice of substitution of securities which they employ either directly or indirectly. In carrying out the direct method, the company selects the better securities from among its holdings and pledges these as collateral in support of an issue of bonds or notes which are sold to the public. The money thus secured is then used for further finance operations. In availing itself of the second method, the company causes a new company to be formed, and an agreement is entered into with it, whereby the new one is obliged to take from the finance company such securities as the latter desires to rid itself of. The new company pays for the securi-

¹ In this connection see also the chart on page 364 which shows the close inter-relation between the great financial concerns of the United States and the railroad and equipment companies.

ties with original capital or with money obtained from bond or note issues secured by a pledge of the securities that it assumes. Companies of this type are *securities-assumption companies*. They may be either independent companies, or subsidiaries of the companies whose securities they agree to assume, but the latter is more frequently the case.

While finance and assumption companies are characteristically European institutions, occurring in very large numbers particularly in Germany, there are, nevertheless, many excellent examples in the United States. A description of some of those found in this country will serve to explain their uses and inter-relations.

American Finance and Assumption Companies.—The contrast in methods of financing subsidiaries that are being used by the two largest electrical manufacturing and constructing companies of the United States illustrates in an admirable way the use that can be made of finance and assumption companies. The two companies referred to are the Westinghouse Manufacturing Company and the General Electric Company. The former has consistently followed the practice of financing its subsidiaries directly while the latter has made extensive use of finance and assumption companies.

The Westinghouse Company's plan, in brief, has been to take as payment the notes and bonds of companies that it has fitted up with electrical equipment. These notes and bonds are usually secured by the stocks and plants of the companies. Thus, while these companies were not organized as subsidiaries they, nevertheless, remained under the control of the Westinghouse Company until they had paid off their obligations.

The effect on the company of this direct method of financing is well shown by the great increase in the amount of certain items of its balance sheets. These items are investments in securities of other companies, fixed assets,

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notes payable, funded liabilities including bonds and notes outstanding and capital stock outstanding.

Items	March 31 1897	March 31 1903	Oct. 31 1907
Investments.....	\$6,820,952	\$7,407,716	\$29,491,736
Fixed assets.....	14,350,735	20,179,121	49,370,121
Notes payable.....	1,606,658	6,524,000	9,209,766
Funded liabilities.....	1,134,560	3,054,000	29,171,702
Capital stock.....	12,401,664	18,129,150	27,936,815

The great increase in the amount of investments represented by securities of financed companies indicates that the company was obliged to hold these securities for some years before it could profitably dispose of them. To carry this burden in addition to growing plant requirements the company resorted to increasing steadily its capitalization. Its capitalization, which includes funded liabilities and capital stock, rose from about \$13,500,000 in 1897 to over \$57,000,000 in 1907 while the fixed assets, plant and equipment, etc., increased from about \$14,350,000 to \$49,370,000. At the same time the funded liabilities and notes payable increased from \$2,740,000 to \$38,380,000, most of which was used to secure new capital for financing operations. During the credit stringency of 1907 the company was forced into the hands of a receiver in order to straighten out its finances.²

The General Electric Company, on the other hand, met a similar situation successfully by establishing two subsidiaries, namely, the Electrical Securities Corporation and the Electric Bond and Share Company. The former is essentially an assumption company and the latter a finance company.

The Electrical Securities Corporation was formed in 1904 by the General Electric Company in the State of New

² See Dewing, *Corporate Promotions and Reorganizations*.

York. In 1919, its capitalization consisted of \$2,500,000 common stock, all held by the parent company, \$1,000,000 in five per cent cumulative preferred stock and \$4,181,000 in five per cent collateral trust bonds. When the parent company finances a subsidiary directly it receives the stocks and bonds of the subsidiary in payment for the equipment sold to it. These securities are then turned over to the Electrical Securities Corporation which pays the General Electric Company for them out of the proceeds of issues of collateral trust bonds that it sells to the public. These bonds are supported by placing the securities received in the hands of a trustee as a trust fund. The Securities Corporation receives its income from three sources: first, from profits derived from the sale of securities, which, in 1909, reached nearly \$850,000, but varies greatly from year to year; second, from dividends declared on the stocks that it holds, which show a more or less steady decline since 1911; and third, from interest on bonds held, which is its steadiest and in the aggregate its greatest source of revenue. It, thus, continues operation through the principle of substitution of securities, absorbing securities of subsidiaries of the General Electric Company and issuing its own securities in the form of bonds to the public. Dating from the time of its formation in 1904, it had sold to the public fourteen series of collateral trust bonds of which \$4,181,000 were outstanding at the close of 1919.

The Electric Bond and Share Company is a subsidiary finance company of the General Electric Company. It was organized by the latter, in New York, in 1905. In 1919, it had outstanding \$10,000,000 of common stock, all held by the parent company, and \$9,700,000 of preferred stock held by the public. This company carries on its own finance operations directly, purchasing the bonds and stocks of electrical and other undertakings that it has organized to make a market for the products of the General

Electric Company. From time to time, it has caused a number of assumption and control companies to be formed in order to relieve it of its ever-growing supply of investment securities. By 1919, it had seven such companies under its control and through them controlled several score of others. It not only financed these companies, but consolidated and reorganized them and continues to act as fiscal agent for them.

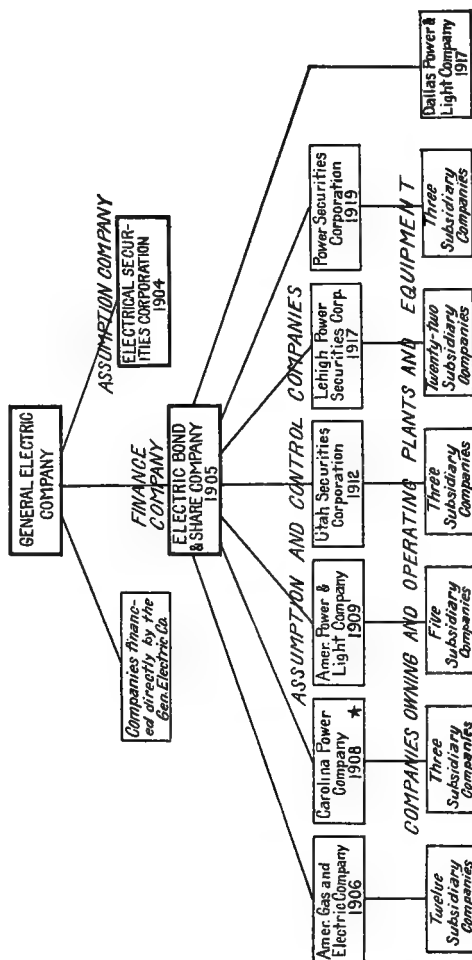
The character of its subsidiary assumption and control companies may be seen from a brief description of the American Power and Light Company. This company was formed in 1909 by the Electric Bond and Share Company to take over the control, through stock ownership, of companies that the latter had previously financed, namely, the Kansas Gas and Electric Company, the Portland Gas and Coke Company, the Pacific Power and Light Company, the Nebraska Power Company, and the Southwestern Power and Light Company. These companies supply electric light and power to 205 communities, artificial gas to 32 communities, natural gas to five communities, street railway service to three communities, water service to seven communities, interurban service to five communities and ice service to two communities.

The accompanying diagram shows the inter-relations existing between the General Electric Company and the finance and assumption companies here mentioned.

The Cities Service Company, incorporated in Delaware in 1910, and which now controls 80 gas, electric light, heat, water, power and traction companies and 25 oil-producing and refining companies, also uses finance companies in building up its subsidiaries. One of these is the Electric Bond Deposit Company, formed in Delaware in 1912. Its first financing venture consisted of assuming \$491,000 first mortgage bonds, \$500,000 preferred stock, and \$262,000 common stock of the Ozark Power and Water Company

to enable the latter to finance and develop a 15,000 horse-power hydro-electric project near Forsyth, Missouri. It

ASSUMPTION AND FINANCE COMPANIES SUBSIDIARY TO THE GENERAL ELECTRIC CO.



had outstanding, in 1919, \$3,000,000 in stock made up of equal amounts of common and preferred, nearly all of which is owned by the Cities Service Company.

Another interesting example of the finance company in the field of public utilities is the Gas and Electric Securities Company, organized in Delaware in 1910, by the Henry L. Doherty interests. It is essentially a finance and not a control company, and was organized primarily to promote and finance the Cities Service Company, mentioned above, but it does not now control this company. Its operations, at the present time, consist of financing the subsidiaries of the Cities Service Company and other enterprises promoted by the Doherty Organization. In order to secure the close coöperation between these several companies that is necessary in successful finance undertakings, a carefully worked out plan of interlocking directors is employed.

A few finance companies are also to be found in the field of mining, development and exploration. For example, the West India Sugar Finance Corporation, formed in Connecticut in 1913, finances sugar companies in the West Indies by making advances to them secured by mortgages, securities, and liens on growing crops. In 1919, it held \$7,000,000 of gold bonds and \$759,165 in stocks of four sugar companies located in Cuba and Porto Rico. In order to supervise somewhat the conduct of companies that it has financed or supplied with credit, it usually provides for representation on the board of directors. It is not a pure finance corporation in so far as it also makes loans without enlisting the principle of substitution of securities.

Specialized, as well as general, finance companies are to be found among mining, land and development enterprises. An example is the Smelters' Securities Company, a subsidiary of the American Smelting and Refining Company. But these companies frequently develop into general finance companies by extending their operations to include a great variety of undertakings. Such a company is the Exploration Company, Limited, originally organized in England with an authorized capital stock of £375,000.

By 1919, it had promoted and financed such diversified enterprises as the South African Real Estate Trust, Ltd., the Exploration Company of England and Mexico, Ltd., the El Oro Mining and Railway Company, Ltd., the Suchi Timber Company, Ltd., the Santa Rosa Mining Company, Ltd., and the Tom Boy Gold Mining Company. It serves also as a control company.

The American International Corporation was formed in New York in 1915 to promote and develop the foreign trade of the United States. It carries on in its own name only general supervisory and research activities, but it also participates in six foreign trade companies through investments in their securities and controls subsidiary companies to carry on trading and finance activities and others to manage its affairs in foreign countries. The activities of the finance companies are described as "Development undertakings, governmental or private, at home or abroad, which usually involve the purchase of securities to provide funds for carrying on the work and also the supervision of the work during its progress." The more important of these finance companies are the China Corporation, formed in 1916, to hold, develop, sell or otherwise dispose of any rights, franchises, concessions, etc., and to enter into contracts of all kinds with governments, corporations and individuals; the Siems-Carey Railway & Canal Company, to construct and operate canals, waterways, irrigation systems, railroads, railways, telephone and telegraph lines, etc., in foreign and domestic countries, and the Latin American Corporation, to promote and finance undertakings and enterprises in South America and to see them through the formative period. It is quite obvious that the American International Corporation is, thus, prepared to undertake through subsidiaries general finance operations covering a whole array of industries.

There are also a few other excellent examples of assump-

tion companies in the United States. Among these may be mentioned the St. Lawrence Securities Company and the American Pipe & Construction Securities Company. The former was organized in 1906, as a subsidiary of the Aluminum Company of America, to relieve the parent company of the securities of the St. Lawrence River Power Company and three others. It, thus, combines the functions of assumption and control. The other company was organized in 1916, by the American Pipe & Construction Company to relieve the latter of securities that it had received in payment for water works, gas plants, electric light and power plants and street railways constructed for subsidiary and other corporations. The Construction Company sold to the Securities Company bonds to the face value of \$7,000,000 and received in return \$3,000,000 in stock and \$3,000,000 in 6 per cent collateral trust bonds of the Securities Company. It then sold the preferred stock and the bonds to acquire new capital, but retained control of its new subsidiary through the common stock.

Finance and Assumption Companies in Germany.—While there are but few finance and assumption companies in the United States and England, they are as common in some of the countries of Continental Europe as they are rare with us. This is particularly true of Germany, and of such countries as have adopted corporation laws patterned after those of that country.

The German law well illustrates the influence that legislation may exercise in molding the form that advanced types of ownership organization shall take. Elaborate provisions have been made to insure the genuine nature of the valuation of the original assets. The starting of a business corporation with an insufficiently subscribed capital is also prevented through a provision requiring that the corporate existence of a company can not possibly begin before its whole capital has been subscribed, and before

at least 25 per cent of the authorized capital stock, payable in cash, is in the actual possession of the managers. The law provides for two modes of forming a company: (1) the *simultaneous* method, whereby the promoters take up the whole authorized capital stock and offer it to the public after the formation of the company; (2) the *successive* method, whereby the promoters are permitted to offer the shares to the public for subscription before the registration of the company; but in either case the whole of the authorized capital stock must be subscribed to before the corporation can begin business. However, the successive method of promoting is very rarely employed because of the requirements laid down by the Stock Exchange Statute of 1896. This law prescribes: (1) The compulsory issue of a prospectus, the authors of which are under an especially stringent liability; (2) the lapse of a space of time between the incorporation of the company and the public issue of its securities, in so far as the securities are not negotiable on any authorized exchange unless at least one year has elapsed from the date of registration of the company and unless the first yearly balance sheet of the company has been published together with the profit and loss account, and (3) the fixing of a minimum authorized capital for companies whose securities are to be dealt in on the exchanges.

While the successive method of formation has, under English and American law, become practically the only method of forming corporations, in Germany it is so hemmed in by exacting statutes that it is avoided whenever possible. The most practical method of formation in that country, therefore, is to have all of the capital stock subscribed to and the full capital paid in at once. This, coupled with the waiting period required by the Stock Exchange Law, not only makes it necessary to finance the companies, but also effectively prevents a quick reconver-

sion into cash of the securities purchased in finance operations. These difficulties have been satisfactorily overcome through the acceptance, by the German banks, of a large portion of the financing burden and by the establishment of large numbers of securities assumption and of finance companies. As a result, these two types of securities-substitution companies are as characteristic of the industrial organization of Germany as is the control company of the American system. These finance companies are either independent companies or subsidiaries of one or more other concerns; and they may undertake to finance all kinds of industrial enterprises or confine their operations to given industries. The assumption companies, of course, are ordinarily closely connected with, and usually controlled by, the companies, or banks, that turn over their holdings in securities to them.

Independent finance companies are by no means as numerous as are those that have been formed by industrial concerns in conjunction with banks as subsidiary companies. It is also characteristic of them that they usually confine their financing operations to undertakings within a given industrial field, rather than to broaden their scope of activity to industry in general. Many of them prefer to call themselves banks, like the "Bank für Naphthaindustrie" and the "Bank für Brauindustrie," although technically they possess none of the characteristics of true banks other than the extension of loans on mortgage bonds and stocks as security. Of the few general independent finance companies whose history is known to us, the *Aktiengesellschaft für Rheinisch-Westfälische Industrie* is perhaps the most prominent. This company, according to Dr. Liefmann,³ was organized in Germany, in 1871, as an investment company, but soon became engaged in financing. It founded successively the *Gelsenkirchen-*

³ Robert Liefmann, *Beteiligungs-und Finanzierungsgesellschaften*.

Schalker gas and water works, a paper factory, numerous mining companies, assisted in financing a cement factory, an industrial chemical company, a wooden-ware manufacturing company and a mirror factory, and acquired also an important investment interest in a brewery, a boiler factory and development undertakings. From 1884 to 1900, its dividends fluctuated between 3 and 60 per cent, but since that time it has frequently failed to declare a dividend. This may have been, in part, due to the fact that it made no close connection with assumption companies to which it might turn over its securities, but sold them outright.

The non-independent, or affiliated, finance companies are ordinarily organized by the larger industrial concerns in conjunction with banks. Thus, in 1894, Ludwig Löwe & Company and Bleichröder, Born & Busse, being in need of funds to finance certain electrical undertakings, that they were equipping with machinery, etc., enlisted the aid of three banks, the Diskontogesellschaft, the Dresdener Bank and the Darmstädter Bank. These five concerns, together, formed the Gesellschaft für Elektrische Unternehmungen and supplied it with capital to finance the new enterprises.

Frequently, the industrial concern is itself financially strong enough to build up its own finance companies. In 1897, the Allgemeine Elektrizitäts Gesellschaft (General Electric of Germany) acquired a Swiss company, the Bank für Elektrische Unternehmungen, which it has since used very effectively to finance several score of companies.

The more important holdings of the Bank für Elektrische Unternehmungen according to its report for 1911-1912 were as follows: ⁴

⁴ The table is an adaptation from R. Liefmann's *Beteiligungs- und Finanzierungsgesellschaften*, pp. 466-467.

GROUP I — ELECTRIC LIGHT & POWER COMPANIES

	Stock outstanding	Amount held by the bank
1. Officine Elettiche Genovesi, Genoa, Italy	17,000,000 Lire	4,000,000
2. Compañía Sevillana de Electricidad, Seville, Spain	10,000,000 Pesetas	4,698,000
3. Compañía Barcelonesa de Elec- tricidad, Barcelona, Spain	18,000,000 "	4,440,000
4. A.-Ges. Elektrizitätswerk Strass- burg, Strasbourg, France	11,750,000 Marks	2,190,000
5. Kraftübertragungswerke Rheinfel- den A.-Ges., Germany	12,000,000 "	3,300,000
6. Deutsch-Überseeische Elektrizitäts Ges., Berlin, Germany	120,000,000 "	5,000,000
7. Schlesische Elektrizitäts u. Gas A.-Ges. Silesia, Germany	11,000,000 "	629,000
8. Markisches Elektrizitätswerk A.- Ges. Berlin, Germany	8,000,000 "	4,000,000
9. Ges. für Elektrische Beleuchtung, St. Petersburg, Russia	40,000,000 Rubles	3,000,000
10. Elektrizitätswerk Abo (Finland) A.-Ges., Berlin, Germany	2,000,000 Marks	1,000,000
11. Elektrizitätswerk Rathausen A.- Ges., Lucerne, Switzerland	4,100,000 Francs	490,000
12. Kraftwerke Laufenberg A.-Ges., Switzerland	15,500,000 "	810,000
13. Società Meridionale di Electtricità, Naples, Italy	10,000,000 Lire	2,000,000
14. Società Idroelettrica Ligure, Milan, Italy	6,000,000 "	2,000,000
15. Compagnie Centrale d'Énergie élec- trique, Paris, France	15,000,000 Francs	812,500
16. Oberrheinische Kraftwerke A.-Ges., Mulhausen, France	20,000,000 Marks	4,400,000
17. Elektrizitätswerk u. Strassenbahn, Königsberg, Germany	2,000,000 "	667,000

GROUP II — TRANSPORTATION COMPANIES

18. Unione Italiana Tramways Elettrici, Genoa, Italy.....	18,000,000 Lire	4,000,000
19. Solinger Kleinbahn A.-Ges., Solingen, Germany.....	2,500,000 Marks	2,500,000
20. Ges. für elektrische Hoch u. Untergrundabnhnen, Berlin.....	50,000,000 “	2,200,000
21. Schlesische Kleinbahn A.-Ges., Kattowitz, Germany.....	10,000,000 “	2,400,000

GROUP III — ELECTRO-CHEMICAL COMPANIES

22. Elektrochemische Werke G.m.b. H., Bitterfeld, Germany.....	5,500,000 Marks	5,500,000
23. Brandenburgische Carbid-u. Elektrizitäts Werke, Germany.....	3,500,000 “	366,000
24. “Nitrum” A.-Ges., Bodio, Switzerland.....	1,000,000 Francs	250,000

GROUP IV — MANUFACTURING COMPANIES

25. A.-Ges. Brown Boveri & Company, Baden, Germany.....	28,000,000 Francs	500,000
26. Felton u. Guillaume Karlswerk A.-Ges., Alsace, France.....	55,000,000 Marks	3,500,000

GROUP V — FINANCE COMPANIES

27. A.-Ges. “Motor,” Baden, Germany	30,000,000 Francs	500,000
28. Watt A.-Ges. für elektrische Unternehmungen, Switzerland.....	10,000,000 “	3,500,000
29. Dinamo, Società Italiana per Imprese Elettriche, Milan, Italy....	5,000,000 Lire	250,000
30. Société Centrale pour l'Industrie électrique, Paris, France.....	20,000,000 Francs	2,000,000
31. Società per lo Sviluppo delle Imprese Elettriche in Italia.....	10,000,000 Lire	4,500,000
32. Elektrizitäts-A.-Ges. vorm. W. Lahmeyer & Company, Germany....	25,000,000 Marks	21,700,000

The Bank and its controlled subsidiaries are reported to have had important stock interests in no less than 80 undertakings in the electrical industry which enabled it to pay a 10 per cent dividend. This company, however, is only

one of many finance and assumption companies connected with the Allgemeine Elektrizitätsgesellschaft.

The finance company seldom stands alone. It is generally more or less closely connected with one or more assumption companies whose purpose it is to afford it an outlet for the securities acquired through finance operations. So we find the Schaffhausensche Bankverein, a finance institution employing the Internationale Bahngesellschaft as an assumption and control company to relieve it of its securities in potash mining and refining companies. Similar companies are to be found in the group of concerns engaged in the construction and operation of local and street railways, the electrical, chemical and petroleum industries.

This inter-relation of companies is well illustrated by the Lenz Group. At the head stands Lenz & Company, G. m. b. H.,⁵ a concern engaged in the manufacture of railway equipment and the construction and operation of local railways. This company, with the assistance of two banks, successively organized six finance and assumption companies, as illustrated in the diagram on opposite page.

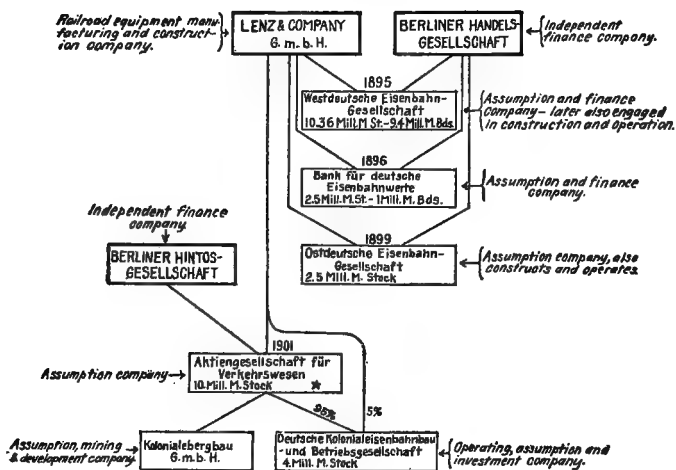
A similar group built up by the Dresdener Bank, also for railway construction and operation, is depicted by Professor Liefmann as follows:

Dresdener Bank and		Bank
Bass & Herz		
Gesellschaft für Industrielle	Unternehmungen	Investment and later a general finance company
Aktiengesellschaft für Bahnbau u. Betrieb		Finance company specializing in railway construction
Deutsche Eisenbahngesellschaft		1st assumption company
Industriebahn-Aktiengesellschaft		2nd assumption company
Local railways in Höxter, etc.		Operating companies

⁵ G. m. b. H. is an abbreviation of Gesellschaft mit beschränkter Haftung (a company with limited liability). It corresponds in general to our corporation.

The two great German electric companies, namely, the Allgemeine Elektrizitätsgesellschaft and the Siemens-Schuckert concern have made lavish use of these two types of companies. In 1915, the former had no less than 35 participation and selling subsidiaries of which the Bank

ASSUMPTION AND FINANCE COMPANIES OF THE LENZ GROUP OF GERMANY
ENGAGED IN RAILROAD CONSTRUCTION AND OPERATION



★ Lenz & Company's interest in the first three companies was transferred to the Aktiengesellschaft für Verkehrswesen on the formation of the latter in 1901.

Data from R. Liefmann's Beteiligungs- und Finanzierungs-gesellschaften.

A. H. STOCKER.

für Elektrische Unternehmungen, previously described, is but one, while the latter had 25 of which 12 were purely assumption or finance companies. The enormous extent of substitution of securities brought about through the Allgemeine Elektrizitätsgesellschaft is commented upon by Professor Liefmann as follows: "Of the total mass of

securities issued by the A. E. G., which, though difficult to estimate accurately, can hardly amount to less than one billion marks, perhaps one half, or surely between 500 and 600 million marks, consists of securities, that in turn are supported by others. These are the securities of the participation companies and of all of the (subsidiary) manufacturing companies which, like the A. E. G. itself, are to a large extent also participation companies.”⁶

The European Petroleum Union was similarly supplied. Among its finance companies were the Ungarische Bank für Industrie und Handel, the Internationale Petroleum-gesellschaft, the Roumanian Trust and the Société belge de pétrole, while the Vienna Banking Association and the Deutsche Bank also aided in financing the combine. The Deutsche Bank had as its chief petroleum securities assumption company the Deutsche Petroleum-Aktien-gesellschaft through which it participated in most of the larger European producing and distributing companies belonging to the Union.

Finance and Assumption Companies in Other Countries.

— While finance and assumption companies are to be found in nearly all countries where the principle of substitution of securities has received the sanction of law, they are nowhere else as characteristic of the industrial organization as in Germany and Belgium. Nevertheless, in England, Switzerland, France and other European countries there are many excellent examples.

Among the English finance companies the two great mining groups of South Africa and several of their subsidiaries and affiliated companies deserve consideration.

The first of these is the famous Cecil Rhodes Group, which, in 1915, included as its chief finance and investment companies the following:

⁶ *Ibid.* p. 479 (Translation by the author).

- (1) Consolidated Goldfields of South Africa, Ltd., formed in 1892 by fusion of the Goldfields of South Africa, Ltd., and the African Gold Share Investment Company, Ltd., as head of the group.
- (2) South African Gold Trust, formed in 1894 by the C. G. of S. A.⁷ as an assumption and investment company.
- (3) Gold Finance Company, formed in 1898 by the C. G. of S. A. as an assumption and investment company, but since liquidated.
- (4) Rhodesia Exploration and Development Company, Ltd., formed by the C. G. of S. A. in 1895 as a finance and investment company which in 1910 absorbed the London & Johannesburg Trust Company, the Rhodesia Banket Company, the Etna Development Company, the Rhodesian Abercorn Shamva Trust Company, and the Gold Schists of Rhodesia.
- (5) Gold Mines Investment Company, Ltd., acquired in 1905 by the C. G. of S. A. as a finance and investment company.
- (6) Goldfields Rhodesia Development Company, Ltd., formed in 1911 by the C. G. of S. A. as an assumption company to take over a large portion of its South African holdings including the Rhodesian Exploration & Development Company.
- (7) Goldfields-American Development Company, formed in 1911 by the C. G. of S. A. to take over its American interests.

Through these subsidiary and controlled companies, the Consolidated Goldfields of South Africa participates in the earning and losses of perhaps more than one hundred other companies including among numerous mining and development undertakings also some finance, investment and assumption companies.

A similar group of finance and assumption companies — also in the mining industry — is that organized by Barnato, Joel and their associates. At the head of this group stands

⁷ C. G. of S. A. is the Consolidated Goldfields of South Africa, Limited.

the Johannesburg Consolidated Investment Company, Ltd., formed in 1889 as an assumption and finance company. Among its controlled companies are the famous De Beers Consolidated Mines and numerous other South African enterprises. It also has extensive holdings in many of the companies in which the Consolidated Goldfields of South Africa also is interested.

A few English finance companies also have been formed to aid in the promotion and development of East India rubber plantations and for colonial development.

In Switzerland we find the Bank für Orientalische Eisenbahnen, organized in Zurich by an international bank consortium; the Union Ottomane, Société pour entreprises électriques en Orient, emanating from the Deutsche Bank; the Schweizerische Eisenbahnbank; the Union financière de Genève; the Société financière pour entreprises électriques aux Etats Unis and numerous others.

In Belgium there are a large number of such companies interested in promoting and financing local and street railways, electric light and power works, and a few that do not specialize in undertakings confined to a single industry. Among the latter the most important one is the Société générale de Belgique, which was first organized in 1822 as an investment company under the name Société générale des Pays-Bas. In 1830, this was changed to Société générale pour favoriser l'industrie nationale. It adopted its present name in 1903.

Evaluation of Finance and Assumption Companies.— We have seen that the modern large business unit, requiring as it does enormous sums of ready money capital that must be available to it at a stated time, must be financed. The investable funds of a country are usually in the hands of banks and trust companies whose business it is to deal in money capital; consequently the institution which undertakes to finance big business enterprises must bridge the

gaps between the underlying economic capital of industry and the money capital.

We have also seen that this financing may be undertaken by industrial corporations themselves, by underwriting syndicates representing banking institutions or by securities-issuing finance companies; and that, while the performance of the function, when undertaken by the syndicate, need not go beyond primary securitization of basic capital, it, nevertheless, frequently involves the substitution of securities resulting from the performance of the function by securities-issuing organizations.

These circumstances give birth to peculiar institutions and new problems. While the underwriting syndicate is but a temporary voluntary association possessing a highly elastic capital, the finance company is a permanent organization with a fixed capitalization that can not be changed except as prescribed by law. Once having undertaken a finance transaction converting its funds into securities, the syndicate tries to sell these to investors at a profit. If it fails it simply apportions to each member his proportionate share and dissolves. Then a new syndicate is formed to undertake the next venture. Here, the finance company is at a disadvantage. It is obliged to keep a steady stream of securities flowing through it in order to enable it to continue operations. It may, of course, sell the acquired securities to investors or keep them, issuing bonds to secure new capital. If it is an independent concern, it obviously has a considerable freedom of choice; but the fact remains that most finance companies are the key-links of the chain that binds the industrial enterprise to its source of funds. Their purpose, therefore, is twofold, namely: on the one hand, to furnish capital and, on the other, to serve as the web of the fabric that unifies an industry. This circumstance limits their freedom of action, and they are forced to devise some means, consistent

with their two-fold purpose, that will enable them to throw off a surplus of acquired securities in order to finance new undertakings. The institution that has so cleverly been devised to perform this new function is the assumption company.

Without the use of the assumption company the finance company would eventually become nothing more than a control or an investment company, depending upon the per cent of securities of financed concerns that it possesses; and sooner or later it must step in to supervise the operation of controlled companies to serve its own interests. In other words, it would soon lose the character of a finance company. But, by successively organizing new assumption companies, either by itself or in conjunction with the banks and industrials that it serves, it is in a position to perpetuate its existence as a finance company indefinitely.

However, the risk of loss entailed in financing new enterprises is a great one. The profits from one venture may be wiped out completely by the losses from another. Consequently, the capital assets of the finance companies, because of the constant change of securities, are subject to extreme fluctuations. It is unlike that of an industrial corporation, or of an investment or control company whose assets tend to remain more fixed in character. Today, the finance company's assets may consist largely of the securities of corporation A, which it has just financed, and a few months hence, they are chiefly composed of the securities of company B. The stockholders of such a company never know of just what securities the capital consists and have no means of ascertaining the financial standing of their company, unless it were to render reports at very frequent intervals. Furthermore, the value ascribed to securities purchased by finance companies in exchange for investment funds is itself a speculation. The price per unit in such cases is not established by the free play of the forces

of demand and supply characteristic of exchange quotations, but is an arbitrary price, based upon the results of a survey of the prospects of success or failure of the financed enterprise.

Under circumstances such as these, the independent finance company can be made to appeal to investors only where there is either a chance for enormous profit, as in mining and tropical exploration enterprises whose speculative character is generally recognized, or in countries where the commercial laws are such as to afford the highest degree of protection to investors through provisions that require full publicity as to the character of the securities possessed by the companies and of the assets that underlie them. In no country are the laws on these points sufficiently firm and exacting, though those of Germany and Belgium most nearly approach the desired end. The independent finance company is, therefore, largely a speculative enterprise, that, through a judicious use of the assumption company, can often diminish the risk somewhat by foisting its less desirable securities off on the latter.

The subsidiary finance company, including such as have been formed jointly by banking institutions and industrials to build up an industry on sound business principles, stands in a better position. It is merely a convenient and admirably adapted tool to facilitate industrial development. It confines its activities to the industry that it serves acting both as a financial agent and as a sort of mortar to hold the individual bricks of the industrial house together, while the several assumption companies that may emanate from it strengthen rather than weaken its position. But, at the same time, if the general public is to be induced to invest in such enterprises, it must be afforded much greater protection by law than it now has. This is especially true of the United States, where the present system of corpora-

tion laws is quite inadequate. Until such time as our laws are strengthened with a view to protecting investors, the use of finance companies in this country must continue to be restricted to the few industries that do their own financing and where they will remain very largely as owned or controlled companies whose securities, other than bonds, will not ordinarily find their way to the general public.

CHAPTER XIX

THE GROWTH AND DEVELOPMENT OF A MONOPOLISTIC CONTROL COMPANY—THE AMERICAN TOBACCO COMPANY

A STUDY of the growth and development of one of the great monopolistic control companies that are such characteristic features of the American system of business ownership will serve to illustrate the great variety of methods that have been employed in building up combinations of this type. The history of the Standard Oil Company, of the United States Steel Corporation, of the American Tobacco Company and others are available for this purpose, but the limits of this work are such as to preclude a description of more than one of them. The brief sketch of the growth of the American Tobacco Company, given in the decision of the Supreme Court of the United States, declaring this company to be a combination in violation of the Sherman Anti-Trust Act, is so admirably suited to this purpose that it is here reprinted in full.¹ The court recounted the undisputed facts as follows:

“The matters to be considered under this heading we think can best be made clear by stating the merest outline of the condition of the tobacco industry prior to what is asserted to have been the initial movement in the combination which the suit assails and in the light so afforded to briefly recite the history of the assailed acts and contracts. We shall divide the subject into two periods, (a) the one from the time of the organization of the first

¹ *United States of America v. American Tobacco Company*, 221 U. S., 106, pp. 155-183.

or old American Tobacco Company in 1890 to the organization of the Continental Tobacco Company, and (b) from the date of such organization to the filing of the bill in this case.

“ Summarizing in the broadest way the conditions which
The tobacco obtained prior to 1890, as to the production,
industry manufacture and distribution of tobacco, the
prior following general facts are adequate to
to 1890. portray the situation.

“ Tobacco was grown in many sections of the country having diversity of soil and climate and therefore was subject to various vicissitudes resulting from the places of production and consequently varied in quality. The great diversity of use to which tobacco was applied in manufacturing caused it to be that there was a demand for all the various qualities. The demand for all qualities was not local, but widespread, extending as well to domestic as to foreign trade, and therefore, all the products were marketed under competitive conditions of a peculiarly advantageous nature. The manufacture of the product in this country in various forms was successfully carried on by many individuals or concerns scattered throughout the country, a larger number perhaps of the manufacturers being in the vicinage of production and others being advantageously situated in or near the principal markets of distribution.

“ Before January, 1890, five distinct concerns — Allen & Ginter, with factory at Richmond, Va.; W. Duke, Sons & Co., with factories at Durham, North Carolina, and New York City; Kinney Tobacco Company, with factory at New York City; W. S. Kimball & Company, with factory at Rochester, New York; Goodwin & Company, with factory at Brooklyn, New York — manufactured, distributed and sold in the United States and abroad 95 per cent of all the domestic cigarette and less than 8 per cent of the smoking tobacco produced in the United States. There is no doubt that these factories were competitors in the purchase of the raw product which they manufactured and in the distribution and sale of the manufactured products. Indeed it is shown that prior to 1890 not only had normal

and ordinary competition existed between the factories in question, but that the competition had been fierce and abnormal. In January, 1890, having agreed upon a capital stock of \$25,000,000, all to be divided amongst them, and who should be directors, the concerns referred to organized the American Tobacco Company in New Jersey, 'for trading and manufacturing,' with broad powers, and conveyed to it the assets and businesses, including good will and right to use the names of the old concerns; and thereafter this corporation carried on the business of all. The \$25,000,000 of stock of the Tobacco Company was allotted to the charter members as follows: Allen & Ginter, \$3,000,000 preferred, \$4,500,000 common; W. Duke, Sons & Co., \$3,000,000 preferred, \$4,500,000 common; Kinney Tobacco Company, \$2,000,000 preferred, \$3,000,000 common; W. S. Kimball & Co., \$1,000,000 preferred, \$1,500,000 common; and Goodwin & Co., \$1,000,000 preferred, \$1,500,000 common.

"There is a charge that the valuation at which the respective properties were capitalized in the new corporation was enormously in excess of their actual value. We, however, put that subject aside, since we propose only to deal with facts which are not in controversy.

"Shortly after the formation of the new corporation the Goodwin & Co. factory was closed and the directors ordered 'that the manufacture of all tobacco cigarettes be concentrated at Richmond.' The new corporation in 1890, the first year of its operation, manufactured about two and one-half billion cigarettes, that is, about 96 or 97 per cent of the total domestic output, and about five and one-half million pounds of smoking tobacco out of a total domestic product of nearly seventy million pounds.

"In a little over a year after the organization of the company it increased its capital stock by ten million dollars. The purpose of this increase is inferable from the considerations which we now state.

"There was a firm known as Pfingst, Doerhoefer & Co., consisting of a number of partners, who had been long and

successfully carrying on the business of manufacturing plug tobacco in Louisville, Kentucky, and distributing it through the channels of interstate commerce. In January, 1891, this firm was converted into a corporation known as the National Tobacco Works, having a capital stock of \$400,000 all of which was issued to the partners. Almost immediately thereafter, in the month of February, the American Tobacco Company became the purchaser of all the capital stock of the new corporation, paying \$600,000 cash and \$1,200,000 in stock of the American Tobacco Company. The members of the previously existing firm bound themselves by contract with the American Tobacco Company to enter its service and manage the business and property sold, and each further agreed that for ten years he would not engage in carrying on, directly or indirectly, or permit or suffer the use of his name in connection with the carrying on of the tobacco business in any form.

Enters the plug tobacco business. (Jan. 1891). "In April following, the American Tobacco Company bought out the business of Philip Whitlock, of Richmond, Virginia, who was engaged in the manufacture of cheroots and cigars, and with the exclusive right to use the name of Whitlock. The consideration for this purchase was \$300,000, and Whitlock agree to become an employee of the American Tobacco Company for a number of years and not to engage for twenty years in the tobacco business.

Enters cigar and cheroot business. (April, 1891). "In the month of April the American Tobacco Company also acquired the business of Marburg Brothers, a well known firm located at Baltimore, Maryland, and engaged in the manufacture and distribution of tobacco, principally smoking and snuff. The consideration was a cash payment of \$164,627.65 and stock to the amount of \$3,075,000. The members of the firm also conveyed the right to the use of the firm's name and agreed not to engage in the tobacco business for a lengthy period.

"Again, in the same month, the American Tobacco

Company bought out a tobacco firm of old standing, also located in Baltimore, known as G. W. Gail & Ax, engaged principally in manufacturing and selling smoking tobacco, buying with the business the exclusive right to use the name of the firm or the partners, and the members of the firm agreed not to engage in the tobacco business for a specified period. The consideration for this purchase was \$77,582.66 in cash and stock to the amount of \$1,760,000. The plant was abandoned soon after.

"The result of these purchases was manifested at once in the product of the company for the year 1891, as will appear from the note in the margin.² It will be seen that

	<i>Number</i>	<i>Pounds</i>
Cigarettes	2,788,788,000	_____
Cheroots and little cigars	40,009,000	_____
Smoking	_____	13,813,354
Fine cut	_____	560,633
Snuff	_____	383,162
Plug	_____	4,442,774
<i>Total output for the United States, 1891</i>		
Cigarettes	3,137,318,596	_____
Smoking	_____	13,813,355
Fine cut	_____	16,968,870
Plug and twist	_____	166,177,951
Snuff	_____	10,674,241

as to cheroots, smoking tobacco, fine cut tobacco, snuff and plug tobacco, the company had become a factor in all branches of the tobacco industry.

"Referring to the occurrences of the year 1891, as in all respects typical of the occurrences which took place in all the other years of the first period, that is during the years 1892, 1893, 1894, 1895, 1896, 1897, and 1898, we content ourselves with saying that it is undisputed that between February, 1891, and October, 1898, including the purchases which we have specifically referred to, the American Tobacco Company acquired fifteen going tobacco concerns doing business in the States of Kentucky, Louisiana, Maryland, Michigan, Missouri, New York, North Carolina, and

² The output of the American Tobacco Company for 1891:

Virginia. For ten of the plants an all cash consideration of \$6,410,235.26 was paid, while the payments for the remaining five aggregated in cash \$1,115,100.95 and in stock \$4,123,000. It is worth noting that the last purchase, in October 1898, was of the Drummond Tobacco Company, a Missouri corporation dealing principally in plug, for which a cash consideration was paid of \$3,457,500.

"The corporations which were combined for the purpose of forming the American Tobacco Company produced a very small portion of plug tobacco. That an increase in this direction was contemplated is manifested by the almost immediate increase of the stock and its use for the purpose of acquiring, as we have indicated, in 1891 and 1892, the ownership and control of concerns manufacturing plug tobacco and the consequent increase in that branch of production. There is no dispute that as early as 1893 the president of the American Tobacco Company, by authority of the corporation, approached leading manufacturers of plug tobacco and sought to bring about a combination of

the plug tobacco interests, and upon the failure to accomplish this, ruinous competition, by lowering the price below its cost, ensued. As a result of this warfare, which continued until 1898, the American Tobacco Company sustained severe losses aggregating more than four millions of dollars. The warfare produced its

natural result, not only because the company acquired during the last two years of the campaign, as we have stated, control of important plug tobacco concerns, but others engaged in that industry came to terms. We say this because in 1898, in connection with several leading plug manufacturers, the American Tobacco Company organized a New Jersey corporation styled the Continental Tobacco Company, for "trading and manufacturing," with a capital of \$75,000,000, afterwards increased to \$100,000,000. The new company issued its stock and took transfers to the plants, assets and businesses of five large and successful competing plug manufacturers.³

³ P. J. Sorg Co., having factory at Middletown, Ohio, who re-

"The American Tobacco Company also conveyed to this corporation, at large valuations, the assets, brands, real estate and good will pertaining to its plug tobacco business, including the National Tobacco Works, the James G. Butler Tobacco Co. Co., Drummond Tobacco Company, and Brown Tobacco Co., receiving as consideration \$30,274,200 of stock (one-half common and one-half preferred), \$300,000 cash, and an additional sum for losses sustained in the plug business during 1898, \$840,035. Mr. Duke, the president of the American Tobacco Company, also became president of the Continental Company.

"Under the preliminary agreement which was made looking to the formation of the Continental Tobacco Company, that company acquired from the holders all the \$3,000,000 of the common stock of the P. Lorillard Company in exchange for \$6,000,000 of its stock, and \$1,581,300 of the \$2,000,000 preferred in exchange for notes aggregating a sum considerably larger. The Lorillard Company, however, although it thus passed practically under the control of the American Tobacco Company by virtue of its ownership of stock in the Continental Company, was not liquidated, but its business continued to be conducted as a distinct corporation, its goods being marked and put upon the market just as if they were the manufacture of an independent concern.

ceived preferred stock \$4,350,000, common stock \$4,525,000, and cash \$224,375.

John Finzer and Brothers, having factory at Louisville, Ky., who received preferred stock \$2,250,000, common stock \$3,050,000, and cash \$550,000.

Daniel Scotten & Co., having factory at Detroit, Mich., who received preferred stock \$1,911,100, and common stock \$3,012,500.

P. H. Mayo & Bros., having factory at Richmond, Va., who received preferred stock \$1,250,000, common stock \$1,925,000, and cash \$66,125.

John Wright Co., having factory at Richmond, Va., who received preferred stock \$495,000, common stock \$495,000, and cash \$4,116.67.

“ Following the organization of the Continental Tobacco Company the American Tobacco Company increased its capital stock from thirty-five millions of dollars to seventy millions of dollars, and declared a stock dividend of one hundred per cent on its common stock, that is, a stock dividend of \$21,000,000.

“ As the facts just stated bring us to the end of the first period which at the outset we stated it was our purpose to review, it is well briefly to point out the increase in the power and control of the American Tobacco Company and the extension of its activities to all forms of tobacco products which had been accomplished just prior to the organization of the Continental Tobacco Company. Nothing could show it more clearly than the following: At the end of the time the company was manufacturing 86 per cent or thereabouts of all the cigarettes produced in the United States, above 26 per cent of all the smoking tobacco, more than 22 per cent of all plug tobacco, 51 per cent of all little cigars, 6 per cent each of all snuff and fine cut tobacco, and over 2 per cent of all cigars and cheroots.

“ A brief reference to the occurrences of the second period; that is, from and after the organization of the Continental Tobacco Company up to the time of the bringing of this suit, will serve to make evident that the transactions in their essence had all the characteristics of the occurrences of the first period.

“ In the year 1899 and thereafter either the American or the Continental company, for cash or stock, at an aggregate cost of fifty millions of dollars (\$50,000,000), bought and closed up some thirty competing corporations and partnerships theretofore engaged in interstate and foreign commerce as manufacturers, sellers and distributors of tobacco and related commodities, the interested parties covenanting not to engage in the business. Likewise the two corporations acquired for cash, by issuing stock, and otherwise, con-

trol of many competing corporations now going concerns, with plants in various States, Cuba and Porto Rico, which manufactured, bought, sold and distributed tobacco products or related articles throughout the United States and foreign countries, and took from the parties in interest covenants not to engage in the tobacco business.

"The plants thus acquired were operated until the merger in 1904, to which we shall hereafter refer, as a part of the general system of the American and Continental companies. The power resulting from and the purpose contemplated in making these acquisitions by the companies just referred to, however, may not be measured by considering alone the business of the company directly acquired since some of these companies were made the vehicles, as representing the American or Continental company, for acquiring and holding the stock of other and competing companies thus amplifying the power resulting from the acquisitions directly made by the American or Continental company, without ostensibly doing so. It is besides undisputed that in many instances the acquired corporations with the subsidiary companies over which they had control through stock ownership were carried on ostensibly as independent concerns disconnected from either the American or the Continental company, although they were controlled and owned by one or the other of these companies. Without going into details on these subjects, for the sake of brevity, we append in the margin a statement of the corporations thus acquired with the mention of the competing concerns which such corporations acquired.⁴

"It is of the utmost importance to observe that the acquisitions made by the subsidiary corporations in some cases likewise show the remarkable facts stated above, that is, the disbursement of enormous amounts of money to acquire plants, which on being purchased were not utilized but were immediately closed. It is also to be remarked, that the facts stated in the memorandum in the margin show on their face a singular identity between the conceptions which governed the transactions of this latter

⁴ Note omitted.

period with those which evidently existed at the very birth of the original organization of the American Tobacco Company, as exemplified by the transactions in the first period. A statement of particular transactions outside of those previously referred to as having occurred during the period in question will serve additionally to make the situation clear. And to accomplish this purpose we shall, as briefly as may be consistent with clarity, separately refer to the facts concerning the organization during the second period of the five corporations which were named as defendants in the bill, as heretofore stated and which for the purpose of designation we have hitherto classified as accessory defendants, such corporations being the American Snuff Company, American Cigar Company, American Stogie Company, MacAndrews & Forbes Company (licorice), and Conley Foil Company.

“(1). *The American Snuff Company*

As we have seen, the American Tobacco Company at the commencement of the first period produced a very small quantity of snuff. Its capacity, however, in that regard was augmented owing particularly to the formation of the Continental Tobacco Company and the acquisition of the Lorillard Company, by which it came to be a serious factor as a snuff producer. There shortly ensued an aggressive competition in the snuff business between the American Tobacco Company, with the force acquired from the vantage ground resulting from the dominancy of its expanded organization, and others in the trade operating independently of that organization. The result was identical with that which had previously arisen from like conditions in the past.

The snuff business is transferred to the Am. Snuff Co. “In March, 1900, there was organized in New Jersey a corporation known as the American Snuff Company, with a capital of \$25,000,000, one-half preferred and one-half common, which took over the snuff business of the P. Lorillard Com-

pany, Continental Tobacco Company and the American Tobacco Company, with that of a large competitor, viz: The Atlantic Snuff Co. The stock of the new company was thus apportioned: Atlantic Snuff Company, preferred, \$7,500,000, common, \$25,000,000;⁵ P. Lorillard Company, preferred, \$1,124,700, common, \$3,459,400; The American Tobacco Company, preferred, \$1,177,800, common, \$3,227,500; Continental Tobacco Company, preferred, \$197,500 common, \$813,100. The stock issued to the Continental Tobacco Company and the defendants, P. Lorillard Company and the American Tobacco Company, is still held by the latter, and they have at all times had a controlling interest in the Snuff Company. All the companies, together with their officers and directors, covenanted that they would not thereafter engage as competitors in the tobacco business or the manufacture, sale, or distribution of snuff.

"Among the assets transferred by the Atlantic Snuff Company to American Snuff Company were all the shares (\$600,000) of W. E. Garrett & Sons, Inc., then and now one of the oldest and very largest producers of snuff, for a long time and still engaged at Yorkland, Del., in interstate and foreign commerce in tobacco and its products, and which controlled through stock ownership the Southern Snuff Company, Memphis, Tenn., Dental Snuff Company, Lynchburg, Va., and Stewart-Ralph Snuff Company, Clarkeville, Tenn. The separate existence of W. E. Garrett & Son, Inc., has been preserved and its business conducted under the corporate name. In March, 1900, the American Snuff Company acquired all the shares of George W. Helme Company, one of the oldest and largest producers of snuff and actively engaged at Helmetta, N. J., in interstate and foreign commerce in competition with defendants, by issuing in exchange therefor \$2,000,000 preferred stock and \$1,000,000 common; and it thereafter took a conveyance of all assets of the acquired company and now operates the plant under its own name.

"As a result of the transactions just stated it came to

⁵ Thus in original. Probably \$2,500,000.

pass that the American Tobacco Company, which had at the end of the first period only a very small percentage of the snuff manufacturing business, came virtually to have the dominant control as a manufacturer of that product.

"2. Conley Foil Company — manufacturers of tin-foil, an essential for packing tobacco products:

In December, 1899, the American Tobacco Company secured control of the business of John Conley & Sons, a partnership of New York City. By agreement the Conley Foil Company was incorporated in New York "for trading and manufacturing," etc., with \$250,000 capital, ultimately increased to \$825,000. The corporation took over the business and assets of the firm, and the American Tobacco Company became owner of a majority of the shares of stock. The Conley Foil Company has acquired all the shares of stock of the Johnson Tinfoil & Metal Company, of St. Louis, a leading competitor, and they supply under fixed contracts at remunerative prices the tinfoil used by the defendants, which constitutes the major part of the total production in the United States.

**Enters the
tinfoil
business.
(1899).**

"3. American Cigar Company:

Prior to 1901 the American and Continental tobacco companies manufactured, sold, and distributed cigars, stogies, and cheroots. In the year stated the companies determined to engage in the business upon a larger scale. Under agreement with Powell, Smith & Company, large manufacturers and dealers in cigars, they caused the incorporation in New Jersey of the American Cigar Company "for trading and manufacturing," etc., to which all three conveyed their said business and it has since carried on the same. The American and Continental Companies each acquired 46½ per cent of the shares, and Powell, Smith & Company 7 per cent; the original capitalization was \$10,000,000 (afterwards \$20,000,000), and more than three-fourths is owned

**Manufacturers and dealers in cigars are consolidated and the Am. Cigar Co., is formed,
(1901).**

by the former. The Cigar Company acquired many competitors (partnerships and corporations) engaged in interstate and foreign commerce, taking from the parties covenants against engaging in the tobacco business; and it has also procured the organization of controlled corporations which have acquired competing manufacturers, jobbers, and distributors in the United States, Cuba, and Porto Rico. It manufactures, sells and distributes a considerable percentage of domestic cigars; is the dominating factor in the tobacco business, foreign and domestic, in Cuba and Porto Rico, and is there engaged in tobacco planting. It also controls corporate jobbers in California, Alabama, Virginia, Pennsylvania, Georgia, Louisiana, New Jersey, and Tennessee.

"4. The MacAndrews & Forbes Company — manufacturers of licorice:

There is no question that licorice paste is an essential ingredient in the manufacture of plug tobacco, and that one who is debarred from obtaining such paste would therefore be unable to engage in or carry on the manufacture of such product. The control over this article was thus secured: In May, 1902, the Continental Company secured control of MacAndrews and Forbes Co., of Newark, New Jersey, and organized 'for trading and manufacturing' a corporation known as the MacAndrews & Forbes Co., with a capital of \$7,000,000, \$4,000,000 preferred and \$3,000,000 in common, which took over the business of MacAndrews and Forbes and another large competitor. The Continental Company acquired two-thirds of the common stock by agreeing to purchase its supply of paste from the new company. The American Tobacco Company, at the time of the filing the bill, was the owner of \$2,112,900 of the common stock and \$750,000 preferred. By various purchases and agreements the MacAndrews & Forbes Company acquired, substantially, the business of all competitors. Thus in June, 1902, it purchased the busi-

Secures
control of
the
manufacture
of licorice,
(1902).

ness of the Stamford Mfg. Co., of Stamford, Connecticut, and incorporated the National Licorice Company, which acquired the business of Young & Smylie and F. B. & V. P. Scudder, and the National Company agreed with MacAndrews & Forbes not to produce licorice for tobacco manufacturers. In 1906 all the stock in the J. S. Young Company (\$1,800,000), which had been organized to take over the business of the J. S. Young Co., of Baltimore, Md., was acquired by the MacAndrews & Forbes Co. The MacAndrews & Forbes Co., use in excess of 95 per cent of the licorice root consumed in the United States.

" 5. American Stogie Company:

In May, 1903, the American Cigar Company and the American and Continental Tobacco Companies caused the American Stogie Company to be incorporated in New Jersey, with \$11,979,000 capital, which immediately took over the stogie and tobie business of the companies named in exchange for \$8,206,275 stock and then in the usual ways acquired the business of others in the manufacture, sale and distribution of such products, with covenants not to compete. It acquired in exchange for \$3,647,725 stock all shares of United States Cigar Company (which had previously acquired and owned the business of important competitors) and subsequently took the conveyance of the plant and assets. The majority shares always have been held by defendant, the American Cigar Company.

" As we think the legitimate inferences deducible from the undisputed facts which we have thus stated will be sufficient to dispose of the controversy, we do not deem it necessary to expand this statement so as to cause it to embrace a recital of the undisputed facts concerning the entry of the American Tobacco Company into the retail tobacco trade through the acquisition of a controlling interest in the stock of what is

The Am. Stogie Co. is formed to take over the stogie and tobie business, (1903).

Enters the retail tobacco business by acquiring the United Cigar Stores Co.

known as the United Cigar Stores Company, as well as to some other subjects which for the sake of brevity we likewise pass over, in order to come at once to a statement concerning the foreign companies.

"The English Companies:

In September, 1901, the American Tobacco Co., purchased for \$5,347,000 a Liverpool (Eng.) corporation, known as Ogden's Limited, there engaged in manufacturing and distributing tobacco products. A trade conflict which at once ensued caused many of the English manufacturers to combine into an incorporation known as the Imperial Tobacco Company of Great Britain and Ireland, capital 15,000,000, afterwards increased to 18,000,000, pounds sterling. The trade war was continued between this corporation and the American Tobacco Company, with a result substantially identical with that which had hitherto, as we have seen, arisen from such a situation.

"In September, 1902, the Imperial and the American companies entered into contracts (executed in England) stipulating that the former should limit its business to the United Kingdom, except purchasing leaf in the United States (it buys 54,000,000 pounds annually); that the American companies should limit their business to the United States, its dependencies and Cuba; and that the British-American Tobacco Company, with capital of 6,000,000 pounds sterling apportioned between them, should be organized, take over the export business of both, and operate in other countries, etc. This arrangement was immediately put into effect and has been observed.

"The Imperial Company holds one-third and the American Company two-thirds of the capital stock of the British-American Tobacco Company, Limited. The latter company maintains a branch office in New York City and the

Enters the English market, (1901).

Enters into agreements with English companies to divide the world's market. The British-American Tobacco Co. is formed, (1902).

vice-president of the American Tobacco Company is a principal officer. This company uses large quantities of domestic leaf, partly exported to various plants abroad and about half manufactured here and then exported. By agreement, all this is purchased through the American Tobacco Company. In addition to many plants abroad it has warehouses in various states and plants at Petersburg, Va., and Durham, N. C., where tobacco is manufactured and then exported.

"The purchase of necessary leaf tobacco in the United States by the Imperial Company is now made through a resident general agent and is exported as a part of foreign commerce.

"Not to break the continuity of the narrative of facts we have omitted in the proper chronological order to state the facts relative to what was known as the Consolidated Tobacco Company. We now particularly refer to that subject.

"The Consolidated Tobacco Co.:

In June, 1901, parties largely interested in the American and Continental companies caused the incorporation in New Jersey of the Consolidated Tobacco Company, capital \$30,000,000 (afterwards \$40,000,000), with broad powers and perpetual existence; to do business throughout the world, and to guarantee securities of other companies, etc. A majority of shares was taken by a few individuals connected with the old concerns: A. N. Brady, F. B. Duke, A. H. Payne, Thomas Ryan, W. C. Whitney, and P. A. B. Widener. J. B. Duke, president of both the old companies, became president of the Consolidated. Largely in exchange for bonds the new company acquired substantially all the shares of common stock of the old ones. Its business, of holding and financing, was continued until 1904, when with the American and Continental Companies, it was merged into the present American Tobacco Company.

The Consolidated Tobacco Co. is organized to centralize control, (1901).

“ By proceedings in New Jersey, October, 1904, the (old) American Tobacco Company, Continental Tobacco Company, and Consolidated Tobacco Company, were merged into one corporation, under the name of The American Tobacco Company, the principal defendant here. The merged company, with perpetual existence, was capitalized at \$180,000,000 (\$80,000,000 preferred, ordinarily without power to vote).
 The Consolidated, the Continental and the old Am. Tob. Co. are merged into the new Am. Tobacco Co., (1904).

“ The powers conferred by the charter are stated in the margin.⁶

“ Prior to the merger the Consolidated Tobacco Company, a majority of whose \$40,000,000 share capital was held by J. B. Duke, Thomas F. Ryan, William C. Whitney, Antony N. Brady, Peter A. B. Widener and Oliver H. Payne, had acquired, as already stated, nearly all common shares of both old American and Continental companies, and thereby control. The preferred shares, however, were held by many individuals. Through the method of distribution of the stock of the new company, in exchange for shares in the old American and in the Continental Company it resulted that the same six men in control of the combination through the Consolidated Tobacco Company continued that control by ownership of stock in the merged or new American Tobacco Company. The assets, property,

⁶ To buy, manufacture, sell and otherwise deal in tobacco and the products of tobacco in any and all forms; to guarantee dividends on any shares of the capital stock of any corporation in which said merged corporation has an interest as stockholder; to carry on any business operations deemed by such merged corporation to be necessary or advisable in connection with any of the objects of its incorporation or in furtherance of any thereof, or tending to increase the value of its property or stock; to conduct business in all other States, territories, possessions and dependencies of the United States of America, and in all foreign countries; to purchase or otherwise acquire and hold, sell, assign, transfer, mortgage, pledge, or otherwise dispose of the shares of the capital stock or of any bonds, securities, or other evidence of indebtedness created by any other corporation or corporations of this or any other State or government, and to issue its own obligations in payment or exchange therefor.

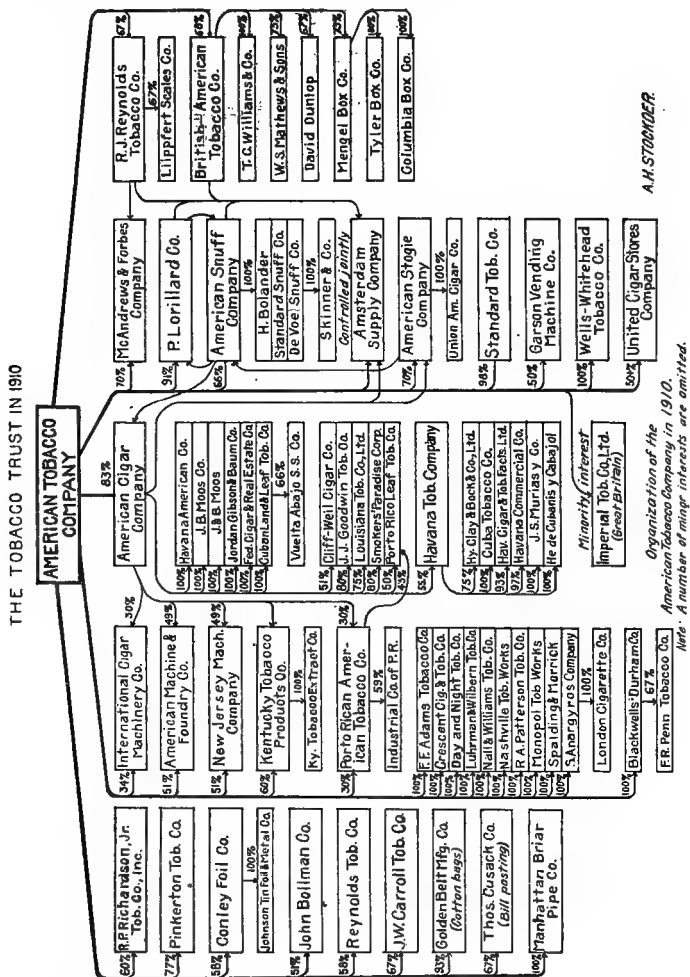
etc., of the old companies passed to the American Tobacco Company (merged), which has since carried on the business.

"The record indisputably discloses that after this merger the same methods which were used from the beginning continued to be employed. Thus, it is beyond dispute: First, that since the organization of the new American Tobacco Company that company has acquired four large tobacco concerns, that restrictive covenants against engaging in the tobacco business were taken from the sellers, and that the plants were not continued in operation but were at once abandoned. Second, that the new company has besides acquired control of eight additional concerns, the business of such concerns being now carried on by four separate corporations, all absolutely controlled by the American Tobacco Company, although the connection as to two of these Companies with that corporation was long and persistently denied.

* * * * *

"Thus reaching the end of the second period and coming to the time of the bringing of the suit, brevity prevents us from stopping to portray the difference between the condition in 1890 when the (old) American Tobacco Company was organized by the consolidation of five competing cigarette concerns and that which existed at the commencement of the suit. That situation and the vast power which the principal and accessory corporate defendants and the small number of individuals who own a majority of the common stock of the new American Tobacco Company exert over the marketing of tobacco as a raw product, its manufacture, its marketing when manufactured and its consequent movement in the channels of interstate commerce indeed relatively over foreign commerce and the commerce of the whole world, in the raw and manufactured products stand out in such bold relief from the undisputed facts which have been stated as to lead us to pass at once to the second fundamental proposition which we are required to consider. That is, the construction of the Anti-

Trust Act and the application of the act as rightly construed to the situation as proven in consequence of having



determined the ultimate and final inferences properly deducible from the undisputed facts which we have stated."

“Considering then the undisputed facts which we have previously stated, it remains only to determine whether they establish that the acts, contracts, agreements, combinations, etc., which were assailed were of such an unusual and wrongful character as to bring them within the prohibitions of the law. That they were, in our opinion, so overwhelmingly results from the undisputed facts that it seems only necessary to refer to the facts as we have stated them to demonstrate the correctness of this conclusion. Indeed, the history of the combination is so replete with the doing of acts which it was the obvious purpose of the statute to forbid, so demonstrative of the existence from the beginning of a purpose to acquire dominion and control of the tobacco trade, not by the mere exertion of the ordinary right to contract and to trade, but by methods devised in order to monopolize the trade by driving competitors out of business, which were ruthlessly carried out upon the assumption that to work upon the fears or play upon the cupidity of competitors would make success possible. We say these conclusions are inevitable, not because of the vast amount of property aggregated by the combination, not because alone of the many corporations which the proof shows were united by resort to one device or another. Again, not alone because of the dominion and control over the tobacco trade which actually exists, but because we think the conclusion of wrongful purpose and illegal combination is overwhelmingly established by the following considerations:

“ (a) By the fact that the very first organization or combination was impelled by a previously existing fierce trade war, evidently inspired by one or more of the minds which brought about and became parties to that combination.

“ (b) Because, immediately after that combination and the increase of capital which followed, the acts which ensued justify the inference that the intention existed to use the power of the combination as a vantage ground to

**Why the
Supreme
Court
ordered the
dissolution
of the
tobacco
combine.**

further monopolize the trade in tobacco by means of trade conflicts designed to injure others, either by driving competitors out of business or compelling them to become parties to a combination — a purpose whose execution was illustrated by the plug war which ensued and its results, by the snuff war which followed and its results, and by the conflict which immediately followed the entry of the combination in England and the division of the world's business by the two foreign contracts which ensued.

“(c) By the ever-present manifestation which is exhibited of a conscious wrong-doing by the firm in which the various transactions were embodied from the beginning, ever changing but ever in substance the same. Now the organization of a new company, now the control exerted by the taking of stock in one or another or in several, so as to obscure the result actually attained, nevertheless uniform, in their manifestations of the purpose to restrain others and to monopolize and retain power in the hands of the few who it would seem, from the beginning contemplated the mastery of the trade which practically followed.

“(d) By the gradual absorption of control over all the elements essential to the successful manufacture of tobacco products, and placing such control in the hands of seemingly independent corporations serving as perpetual barriers to the entry of others into the tobacco trade.

“(e) By persistent expenditure of millions upon millions of dollars in buying out plants, not for the purpose of utilizing them, but in order to close them up and render them useless for the purposes of trade.

“(f) By constantly recurring stipulations, whose legality, isolatedly viewed, we are not considering, by which numbers of persons, whether manufacturers, stockholders or employees, were required to bind themselves, generally for long periods, not to compete in the future. Indeed, when the results of the undisputed proof which we have stated are fully apprehended, and the wrongful acts which they exhibit are considered, there comes inevitably to the mind the conviction that it was the danger which it was

deemed would arise to individual liberty and the public well-being from acts like those which this record exhibits, which led the legislative mind to conceive and to enact the Anti-Trust Act, considerations which only serve to clearly demonstrate that the combination here assailed is within the law as to leave no doubt that it is our plain duty to apply its prohibitions."

PART V

ABUSES OF OWNERSHIP ORGANIZATION AND ATTEMPTS TO REMEDY THEM

CHAPTER XX

ABUSES AND WEAKNESSES OF THE AMERICAN SYSTEM

DURING the past three decades many laws have been enacted by congress and the state legislatures that place restrictions upon the freedom of action of business ownership organizations. The state of Ohio was one of the first to enter the lists against big business when it brought suit against the Standard Oil Company of Ohio, to force dissolution of the Standard Oil Trust, of 1882. Within a comparatively short time other states followed this lead by enacting anti-trust legislation, and even the federal congress was prevailed upon to pass the Sherman Anti-Trust Act. From then on there has been a continual fight raging in our legislative bodies to correct abuses and to combat evils that have crept into the ownership organization. At times this has taken the form of investigations by committees and bureaus whose reports have been highly enlightening. Among them we find the 1900 report of the United States Industrial Commission, consisting of some 19 volumes; that of the Hughes' Commission of the state of New York which laid bare the connections of the great insurance companies with big business in the matter of finance and control; the voluminous reports of the Pujo Commission concerning the so-called "Money Trust"; the many reports of the United States Bureau of Corporations, and more recently those of the Federal Trade Commission. Prosecutions have also been numerous both in the state and the federal courts. Their reports are filled with decisions condemning in no doubtful way certain methods

and practices that have been employed by our large and small business organizations.

These events and acts permit of but one interpretation, namely, that there is something wrong in our system of ownership organization. It does not conform in full to our sense of business ethics and morals. It is experiencing difficulty in adjusting a new order of organization to our ideas of propriety as dictated by our laws and customs. Consequently there is ever a tendency to violate the existing laws. Big business units have been perhaps somewhat more culpable in this than have the smaller ones. The former through their control of our basic industries exercise a potent influence upon our daily lives and upon business in general. They are constantly in the public eye. The errors that they commit are seized upon by the publicist and are prominently displayed in newspapers and periodicals. For that reason, but not without some justification, has the general public come to view our big business organizations from a critical angle.

What then, are some of the acts and abuses that have called forth this deluge of criticism?

ACTS AND ABUSES LEADING TO CRITICISM

Generally speaking, the criticism directed against the ownership organization centers upon six things, namely: (1) The methods of administration and control; (2) the methods and practices of promotion and finance; (3) financial management; (4) speculation; (5) unfair methods of competition; and (6) monopolies and combinations in restraint of trade.

1. Administrative Abuses.—From the standpoint of administration and control business has laid itself open to criticism, not so much because of the direct violations of law, but rather because the law has been so lax that it has permitted pernicious practices and abuses to spring up and

has countenanced and tolerated them until public opinion has revolted. While there are many of these laxities of law, a few have stood out more prominently than others. Since most of them have been pointed out here and there in the preceding chapters it will suffice at this point merely to bring them together in the form of a summary.

(a) The ease with which stock may be transferred has made it possible for the criminally inclined manipulator to organize a company which he knows to be unsound, to reserve for himself a large block of the stock and to dispose of his interest at a good profit when the propitious moment arrives. In this way those who have organized the company, and upon whom the responsibility for its conduct should rest, are enabled to slip out before the collapse comes.

(b) The small holdings required of directors have also caused criticism. Through dummy, or controlled directors a small group of stockholders may retain control over the affairs of a large corporation. They can then cause it to be managed for their own personal profit to the detriment of the whole body of stockholders. There may be some advantage in this in so far as it will permit of greater freedom in hiring executive and administrative ability. It is, nevertheless, objectionable because the laws in most states are not such as to hold the directors both civilly and criminally responsible for their acts. The remedy, then, does not appear to be in the direction of more stringent requirements as to qualifications of directors. They must be made responsible to stockholders and creditors for their acts.

(c) The inadequate representation of minorities is another point upon which criticism centers. Under the ordinary system of voting those who can secure by ownership or proxy the right to vote 51 per cent of the voting stock have the right to fill all places on the board of directors.

They may in this way exclude the minority from voicing its opinion or being represented on the board of control. Such a condition has frequently led to factional fights among the stockholders which have been carried to the highest courts. Often enough, in such cases, has the minority been sustained in its claim of mismanagement. The best remedy is to assure the minority of adequate proportional representation. To this end many states have adopted legislation which in some cases prescribes, and in others permits of, the use of the cumulative method of voting. Other states, however, have let this abuse go unchecked by remedial laws. Under this condition the incorporators may choose the practice that is to prevail.

(d) The privilege of proxy has also been abused. Strong, well-organized minorities owning from 25 to 30 per cent of the voting stock have found it easy to maintain themselves in control of the corporation for long periods of years through the use of long-time proxies. Here also, several states have taken action limiting the life of a proxy to a single election, but they are very few in number.

(e) The large number of stockholders and their remoteness from the seat of activity of the enterprise in which they are interested is another contributing influence. The tens of thousands of stockholders of our larger corporations are scattered throughout the forty-eight states and many foreign countries. It is impossible for them to come together at stated intervals to discuss the affairs of the businesses. Many of them have no interest in the management and do not care to assume the burden of active participation in the corporate affairs. Many of them hold the stock for speculative purposes solely, expecting to make a profit, not from dividends, but from a resale of the stock. Others, while they are bona-fide investors who hold stock for the sake of dividends, are perfectly content to let those who have the power control the policies of the corporation

and give their proxies freely or abstain entirely from voting. These circumstances frequently lead to abuses perpetrated by a small, well-organized group of stockholders, whereby such a group seeks gain, irrespective of the effect of their acts upon the great body of more or less disinterested stockholders.

(f) Furthermore, in most of the states there are no definite responsibilities placed upon officers and directors. In but a very few are they made both civilly and criminally liable for infractions of the law. And even where there are such laws, the lack of interest, coupled with an amazing ignorance of their lawful rights on the part of the stockholders, permits the criminally inclined to defraud them without being brought to justice for their misdeeds.

2. Abuses Arising out of Methods of Promoting and Financing Companies.—The manner in which most of our larger business companies have been promoted and financed has been, and still is, the cause of much justifiable criticism. Legislatures have erected few, if any, safeguards against the wild extravagance and unsound practices that have characterized this feature of the formation and operation of our corporations in general. Many of them, organized since 1890, have been highly speculative ventures that, from the beginning, had little chance of success. They floundered along for a few brief years, attempting through speculation and other questionable practices to maintain themselves, only in the end to be reorganized or to become bankrupts and to disappear. Unwise promotion, poor, and sometimes even fraudulent, financing and orgies of speculation have marked their lives. Many of these abuses have been brought to light through the reports of government bureaus, special investigation committees, court proceedings and accounts carried in financial publications. It is quite out of the question to treat them in full in this work, for they are the

proper subject matter for a treatise on corporation finance. Nevertheless, they have functioned so prominently in the development of the modern ownership organization in the United States that they can not be passed by without a word or two of explanation.

(a) *Unwise promotion.* As has already been explained, the work of promotion consists essentially of securing options on the properties to be acquired by the proposed new business, of making provisions for financing and underwriting the issues of securities, of organizing the new company under an appropriate charter, of selling the optioned properties to the company and lastly, of inducing the public to buy the securities from the underwriters. This process frequently has been accompanied by an extravagant use of capitalization, huge profits for the promoters and underwriters and heavy losses for the investors.

The method is admirably summarized by Professor A. S. Dewing, in a study of the promotions and reorganizations of some eighteen large companies in the following words:¹ "The tangible assets averaged 40% of the total issued securities. The remaining 60%, representing usually the overlying stocks, was distributed among five separable interests, although in the majority of cases one or more were merged. These five interests were (1) the promoter who secured the options, (2) the banker who stood god-father for the enterprise or underwrote its securities, (3) the manufacturers who received a price for their plants in excess of their value, (4) the public who received a bonus of common stock for purchasing the securities of the enterprise, (5) the attorneys and others who did the work of incorporating the consolidation. Looking at the matter still in terms of a typical promotion, it would appear that of the 60% in securities above the value of the

¹ A. S. Dewing, *Corporate Promotions and Reorganizations*. Pp. 540-541.

property, 10% went to the promoter for his service, 10% to the banker for his services, 20% to the manufacturers as a gift in excess of the value paid for their plants, 15% to the public as 'bait' to induce the purchase of the securities and 5% for the direct labor incident to incorporation. Such figures represent the roughest approximation. They are susceptible to infinite variations according to the proportions of the bonds and stocks, to the period of promotion, to the kind of industry, to the prevailing sentiment of the public. As rough approximations, however, they are believed to be fair statements of average conditions."

(b) *Over-Capitalization.* In most of the cases described by Dewing, practically all of the common stock was "water" and on the average the actual value of the property acquired by these companies did not exceed the par value of the preferred stock issued against it. As a result, tens of millions of dollars in worthless stocks were foisted off upon the public. In very few instances, indeed, did the new large scale business enterprise grow rapidly enough to fill out the financial clothes that had so generously been supplied to it by the promoter and the underwriting syndicate.

The responsibility for this state of affairs rests by no means upon the promoter alone. These great enterprises could not have been built up without the support and assistance of financiers who could furnish the necessary funds within the short period of time required. The assembling of funds was a joint enterprise in which a large number of financiers had to participate. The large profit resulting from a successful underwriting venture was worth the risk of loss. But the chance for success was better if a large number of banking houses could be brought into the syndicate. There remained then less to criticise. Once having participated in a syndicate the smaller banking houses in provincial districts were obliged thereafter to

accept any and all offers to become syndicate members and to subscribe to the securities of good or bad concerns without distinction. For, if they objected to the bad promotions, they were denied a share in the good ones.

(c) *Influence of Life Insurance Companies.* Up to 1906, the peculiar situation of the life insurance companies also played an important part in the matter of promotions. In the first place, little short of a monopoly in the writing of life insurance had come into the hands of the Equitable, the New York Life and the Mutual companies. They were receiving money faster than they could invest it. At times the Equitable alone had from 30 to 40 million dollars in cash lying uninvested in New York banks. This money was borrowed by the banking syndicates for temporary use in underwriting. Some of the life insurance companies even engaged directly in this work under assumed names. The New York Life Insurance Company, for example, did so under the name "Milik." With all, they furnished the syndicates with a ready market for their securities and by 1904 the three companies mentioned above had invested in stocks and bonds whose aggregate par value was in excess of one billion dollars.² The result was to force the insurance companies to join the bankers in speculative manipulation of the market.

(d) *Supporting the Market.* The promotion is not a success from the underwriters' standpoint unless the securities can be sold at a profit to the public. In order to facilitate their sale, the price of the securities must be kept up. For this purpose the services of a large number of experts were employed to manipulate the Stock Exchange. They call it "supporting the market." The stock must be sold at a price agreed upon as a minimum by the syndicate. If it then appears on the market at less than

² Reports of the committee of the New York Legislature. New York Life Insurance Investigation, 1906.

this amount, it must be bought up. In this way they work off their securities and gently inject them into circulation. The practice is also known as making "wash sales."

Thus, in the reports of the Pujo Commission, the number of shares bought and sold by the syndicate in the promotion of the California Patents Company are shown as follows:

	<i>Bought</i>	<i>Sold</i>
October 5	6,000	11,200
" 7	8,900	4,000
" 10	13,000	17,000
" 22	6,400	10,900
	24,300	43,100

As a result of these wash sales, the net sales were not 43,100 shares, but only 18,800 shares.

(e) *Profits of Underwriting.* A great deal of criticism has also been directed against the profits of the underwriters. Their profits, to be sure, have been large at times. Yet, they are highly problematical, for they are in part a payment for the assumption of an extraordinary risk, and not all underwriting ventures prove to be successful.

In the case of the United States Steel Corporation the underwriters received a bonus of \$25,000,000 in stock and their total profit may have been two or three times as great. The bankers who financed the United States Rubber Company are reported to have received from the company for each \$100 in cash one share of preferred and one share of common stock, each of the par value of \$100. The preferred stock they sold at \$92 per share and the common at \$29.25 per share. This gave them a return of \$121.25 for every \$100 in cash turned over to the company.³ In the case of the American Smelting and Refining Company the underwriters' gross profit was approximately 15 per cent. These are not extraordinary cases; and they seem

³ *Commercial & Financial Chronicle*, Sept. 15, 1915.

to indicate that the profits were large even after the expenses had been deducted from the gross profit.

However, losses have, at times, also been large. In financing the International Pump Company the underwriters suffered a net loss of approximately \$20 out of each \$100 in cash furnished. And in the promotion of the American Malting Company their losses probably exceeded \$70 out of the hundred.

(f) *Promoters' Profits.* Much has been said on the subject of promoters' profits, particularly by Professor Dewing.⁴ Their profits come in the main from two sources. In the first place, there is the legitimate profit derived from the sale of the securities that the promoter receives as his commission, which may amount to 10 per cent of the stock issued. In the second place, there is the illegitimate profit arising out of the practice of "milking the corporation," namely, the purchase of plants, etc., by the promoter and their resale by him at much advanced prices to the company which he is promoting. The latter practice has resulted several times in calling upon the courts to determine what constitutes a proper profit. As a result of one such case,⁵ the promoters of the Old Dominion Copper Mining & Smelting Company were obliged to pay \$2,000,000 of illegitimate profits to the company. In both Germany and England steps have been taken to curb this practice through prescribed and other legal requirements.

3. Abuses in Financial Management.—The financial management of the company following its promotion is equally as important to the general public and the security-holders, as the circumstances surrounding its formation. Our large corporations are managed either by business men, or bankers, or both. The bankers who were origi-

⁴ A. S. Dewing, *Corporate Promotions and Reorganizations*.

⁵ *Journal of Political Economy*, 1900, p. 535.

nally called upon to finance the company during the period of promotion frequently retain control over it and direct its operations afterwards. Indeed, instances are not lacking where not only the original financing, but also the subsequent financial management, was carried on primarily for the benefit of Wall Street and to the detriment of the best interests of the business itself. This appears to have been largely the case with the Rock Island Company, whose failure in 1915 is generally attributed to banker management. On the other hand, where these great businesses remained more or less exclusively in the hands of business men they soon found themselves in financial straits. Large business enterprises are in constant need of financing for purpose of development and to enable many of them to create a market for their products. Hence, they must have the advice and assistance of the bankers. Ignorance of banking methods, of credits and of financing through the substitution of securities on the part of the management of the Westinghouse Electric and Manufacturing Company was largely the cause of its failure in 1907. The same thing was true of the old Claffin Company.

It is thus seen that some failures have been attributable to too much banker management and others to too little. It is hardly necessary to point out that there is a happy medium. Success in modern business, especially where the instrumentalities of organization consist of securities, depends to an extraordinary degree upon a sound financial policy — a policy that will win the support not only of the banking interests but also of the investing public.

Considered in this light, the financial policy of the United States Steel Corporation, exclusive of its promotion, has been exceptionally sound. Handicapped in the beginning by heavy over-capitalization which seriously threat-

ened its existence, it has gradually overcome its difficulties and is today probably the most powerful corporation in existence. Its success in this respect is in no small degree attributable to a combination of excellent industrial managerial ability of such men as Schwab, Corry and Farrell with the financial acumen of Judge Gary. But even this great corporation found it necessary to indulge in financial manipulation to lessen somewhat the burden of over-capitalization under which it labored.

Even today, the management of most of our great business enterprises conducted under the corporate form of organization is still too much in the hands of financiers to the exclusion of men who are equipped with the proper technical and industrial training. This is particularly true of our railway and railway equipment companies; a fact that is clearly brought out by the accompanying chart.

(a) *Financial readjustments.*—If the enterprise is heavily over-capitalized it must sooner or later effect a readjustment. Its financial clothes are too large for it and it must increase its assets or earning power to fill them, or the clothes must be trimmed down to fit the earning power of the corporation. The latter practice seems to have been the more common in this country, where conversions and reorganizations have been frequent.

The principle underlying both the conversion and the reorganization is that of substituting one type of security for another. In the case of a conversion a stock bearing a high rate of dividends may be retired by exchanging for it a bond bearing a low interest rate; but the reorganization is the more drastic and usually entails the cancellation of all or a large part of the common stock, and at times, even of the preferred stock. In either case the security holders usually lose heavily, because the securities, as a rule, will have been sold by the original holders to other

persons for cash. It is only rarely that the original holders suffer.

(b) *Conversions*.—In 1902, the Steel Corporation launched its famous bond conversion plan about which there has been so much controversy. The corporation needed \$50,000,000 of new capital, but the members of the syndicate still held enormous quantities of preferred stock which they had been unable to sell to the public. A new issue of securities to add to those already outstanding was out of the question. The plan adopted proposed “to rearrange your corporation’s capitalization (which in round numbers now consists of \$300,000,000 of bonds, \$500,000,000 of preferred stock, and \$500,000,000 of common stock) by substituting for \$200,000,000 of the preferred stock, \$200,000,000 of sinking fund sixty year 5 per cent mortgage gold bonds, and by selling \$50,000,000 of additional bonds of such issue for cash. As the preferred stock carries 7 per cent dividends, while the bonds would bear but 5 per cent interest, the \$50,000,000 desired could, in this way, be added to the corporate resources, and the aggregate of annual charges for interest and dividends, instead of being increased \$3,500,000 would be decreased \$1,500,000 as compared with the present sum total of these two requirements.”⁶ The plan was not well received by the stockholders who were expected to give up a 7 per cent security for one paying but 5 per cent, and after about \$150,000,000 of the preferred stock had been converted the plan was dropped.

Numerous other big companies, instead of attacking the problem of over-capitalization at once, permitted the claims of the preferred stockholders against the earnings of the company to cumulate until they even exceeded the

⁶ An account of this bond conversion will be found in the *Quarterly Journal of Economics*, Vol. XVIII, 1903, pp. 22-53; also in Ripley, *Trusts, Pools and Corporations*.

total par value of the outstanding stock of this class. In the case of the old United States Leather Company, organized in 1893, the unpaid dividends due the preferred stockholders accumulated rapidly. By 1905, they amounted to 41 per cent of the par value of the stock. In 1906, the company was reorganized, the common stockholders were asked to surrender some 70 per cent of their stock and the preferred stockholders received about 75 cents on the dollar out of their accrued dividends, part of it in the form of new common stock.⁷

(c) *Reorganizations*. — Reorganizations are the usual results of business failure, that is, the failure of the earnings to support the burden of charges that were placed upon them. It is a historical fact that many of the great industrial combinations formed during the early and late nineties had to undergo one or more reorganizations because of an actual or threatened condition of insolvency due to financial embarrassment. According to Dewing,⁸ "these financial difficulties were not the consequence of over-capitalization as is usually alleged. These corporations did not fail because the capitalization items were large or small. They failed because their earnings were inadequate for the load put upon them. If the load was especially burdensome by reason of heavy fixed charges and unwarranted dividend payments, the failure was all the more certain. The direct cause of failure in every instance was the deflection of working capital to the payment of interest and dividends. Beneath this, as the fundamental cause, was the lack of judgment of promoters in placing bonds upon an untried industrial enterprise and lack of conservatism of the early management in paying dividends without due regard to sound principles of finance. Every corporation discussed . . . paid out interest and dividends in the face of falling

⁷ Dewing, *Corporate Promotions and Reorganizations*.

⁸ *Ibid.*, pp. 557 et seq.

earnings, and none need have suffered serious financial difficulties had the amounts paid in interest and dividends been conserved. Many industrial consolidations more extravagantly promoted, with far greater discrepancies between assets and capitalization, have continued in business uninterruptedly to the present time and are prosperous, because their promoters issued no bonds and their directors exercised a wise conservatism."

The same writer is of the opinion that these failures were more fundamentally attributable to two sets of causes. "One psychological in character and concerned with the difficulties attending the administrative management of a large business. The other was economic in character and concerned with the difficulties attending the creation of a business organization sufficiently powerful to dominate an industry in the presence of actual or potential competition."

(d) *Dividend Policies*.—Aside from these abuses there are others that arise out of certain practices regarding the declaration and payment of dividends.

(1) Failure to give proper recognition to depreciation of assets has been extremely common. According to former Chairman Hurley of the Federal Trade Board, out of 60,000 corporations fully one-half failed entirely to recognize the factor of depreciation in their accounts. This, in view of over-capitalization, is a serious condition. Even in the case of corporations that have "wasting assets" such as bodies of ore, stands of timber, veins of coal, etc., far too little attention is paid to this aspect of accounting. Under such conditions the declaration of dividends frequently involves the impairment of assets. This practice, for instance, figured prominently in the failures of the United States Realty Company, the National Starch Company and others.⁹ But in justice, it must be

⁹ *Ibid.*

said that the stronger, more conservative, corporations follow a rigorous policy of setting aside annually a portion of earnings as a replacement reserve.

(2) Failure to distinguish between capital and income in the declaration of dividends has wrecked many a corporation in its infancy. For example, the directors of the old American Malting Company, in spite of the fact that it was highly over-capitalized, succeeded in giving it a seeming prosperity by declaring dividends out of assets. The scheme was finally discovered by the stockholders who then brought suit against the directors to compel them to restore to the company the funds thus misapplied. The trial court sustained the directors, but the Supreme Court of the state of New Jersey reversed this decision on the ground that the original stockholders will change and the new ones would be the ones to suffer, and that the directors also would thereby be permitted to create a fictitious prosperity and then to sell their holdings in the injured corporation to others who were in no position to know that the capital had been impaired. The court, therefore, ordered the directors to reimburse the company.¹⁰ The same practice forced the Consolidated Lake Superior Company into bankruptcy in 1902, and the United States Finishing Company in 1913. In the latter case it was reported that the directors had lifted about \$1,250,000 out of the capital and had distributed this as dividends.¹¹

(3) Insufficient distinction is made between surplus and undivided profits. The surplus may be in the form of investments of various kinds, while the undivided profits are cash earnings susceptible to distribution in the form of dividends. It frequently happens that a corporation has a large surplus but its earnings for the fiscal period have

¹⁰ *Ibid.*

¹¹ See reports concerning these companies in the *Commercial & Financial Chronicle*, 1902 and 1913.

been insufficient to enable it to declare its regular dividends. In such cases, some companies have borrowed money through the issue of purchase-money bonds and have paid the dividends out of this. The question arises, whether this is an impairment of capital. It would seem that the safer procedure would be to declare a scrip dividend. This is now usually done under such circumstances.

(4) Another important question is whether an over-capitalized corporation may pay dividends out of earnings before it has brought its assets up to its capitalization. A number of cases have been brought to court on this point. In many of them, notably one brought against the directors of the National Wall Paper Company in New Jersey in 1907, the court held that the capital account and the dividend account may be kept separately, and that the stockholders may not secure an order restraining directors from declaring dividends out of earnings even when a condition of over-capitalization exists. This is, then, not a matter in which the courts will assume responsibility of protecting the stockholder, but remains a business risk of the investor.

4. Speculation. — Speculation has been the bugbear of the business world ever since the introduction of securities as instrumentalities of organization. It thrives on the ease of transferability of securities and active trading in them on exchanges where prices are quoted from day to day and hour to hour. From the days of John Law and his "Mississippi Bubble," to the present time, it has called forth a deluge of criticism resulting in legislative enactments of a more or less regulatory character.

A speculative interest in securities is essentially different from an entrepreneurial interest. The latter centers upon the earnings accruing to the invested capital underlying the securities, while the former rests upon changes in their market price as quoted on exchanges. The speculator, therefore, is not primarily interested in the condition of the

business and its profits but in its securities as commodities in themselves, commodities that may be bought and sold like so many bushels of wheat.

Professional and amateur speculators abound. They are ordinarily divided into two classes: (1) *bulls* who buy securities with the expectation of being able to sell them at advanced prices and (2) *bears* who sell stocks in the hope of being able to rebuy them at reduced prices. Since a period of generally rising prices favors the first class, it is called a *bull market* and correspondingly a period of generally falling prices is a *bear market*. Thus, one class attempts to bring about a rise in prices while the other tries to depress them. This frequently results in a "corner" in a given security; that is to say, a single speculator, or a group of them, obtains a practical monopoly of the available floating supply. One of the most notorious corners of recent years was in the stock of the Stutz Motors Corporation during which the quoted prices rose from \$89 per share to the dizzy height of \$730 per share. Such speculation in the securities of a company naturally does it little good.

The great bulk of speculative transactions is carried on by means of borrowed money. The speculator ordinarily pays from 10 to 15 per cent of the market price of the securities to the broker, who lends him the balance, retaining possession of the stocks and bonds to support the loan. This method of speculation is called "playing on margin." The broker, in order to get back his working capital, borrows from the banks by pledging the securities in his possession to support a "call loan," that is to say, a loan that does not run for a definite period of time but is subject to termination whenever the bank sees fit to call it. In this way the banks become involved in the speculation, for they really furnish the money for it. Prior to the passage of the Federal Reserve Banking Act, in 1913, there was

little opportunity to control the flow of funds that support the operations of speculators, but the Federal Reserve Board established by virtue of the act of 1913, now finds it possible to exercise some measure of control over this by raising or lowering the rediscount rates which influence the call loan rates.

There are three kinds of speculation in securities; that carried on (1) by outsiders, (2) by insiders, and (3) by the companies themselves. Speculation by outsiders is very extensive, as may be seen by a glance at the table showing the turnover of securities of a number of large companies given in a preceding chapter.¹² By and large, this form of speculation serves a very useful purpose, but in a wasteful way. It makes it possible for underwriters who finance companies to dispose of their securities even though the investing public is not ready to buy them, and thus enables them to free their funds for further financing. But excessive speculation in the securities of a company tends to place it in bad repute with the investing and business public. Thus, in the years immediately following 1896 the common stock of the United States Leather Company was little more than the speculative dice of Wall Street. Ordinarily the stock had been quoted at from \$5 to \$10 a share. In October of 1899, James R. Keene tried to "corner" the floating supply and by November 6th, the price had risen to \$40.87. Two days later it had fallen back to \$20 and by the end of the month it was again quoted at \$10 per share. The original holders seized this brief opportunity to dispose of their common stock reserving for themselves and their families the preferred issues.¹³ The same thing happened to the stock of one of our big rubber companies¹⁴ and many others.

¹² Page 94.

¹³ Dewing, *Corporate Promotions and Reorganizations*, pp. 24-25.

¹⁴ *Analyst*, July, 1915.

Then too, the directors and officers of the company frequently have added to the stigma of speculation by artificially influencing the price of its securities to their own advantage. Cases have come to the attention of the public where financial reports have been falsified, as in the old Whiskey Trust,¹⁵ where dividends have been declared out of capital as in the National Cordage Company¹⁶ and where funds have been shifted between two or more companies to give a semblance of strength in order to enable the insiders to reap a speculative profit out of more or less worthless securities. In 1896, the same people who were in control of the Diamond Match Company also controlled the New York Biscuit Company, and in order to aid them in their speculation they shifted the combined funds of both companies first to support one and then the other, until finally both were in financial straits and the collapse came.¹⁷

At times, those who are in control of a company may feel that it is necessary for them to take a hand in a speculative manipulation in order to protect the company. This may be justifiable, but it is a risky business that may do more harm than good. As a result of such a manipulation by Allen A. Ryan resulting in a "corner" in the stock of the Stutz Motors Company, the Board of Governors of the New York Stock Exchange refused to permit further transactions in this security on the Exchange. Mr. Ryan claimed that certain interests sought to depress the stock in order to damage the company and that he merely stepped in to prevent this. Such operations, however, always make a bad impression upon the public, especially where they are undertaken by and on behalf of the company itself as in the case of a very large company, which from 1903

¹⁵ See Ripley, *Trusts, Pools and Corporations*.

¹⁶ See Dewing, *Corporate Promotions and Reorganizations*.

¹⁷ See *Commercial & Financial Chronicle*, Sept, 1896.

to 1908, was accused of having actually bought and sold its own stocks on margin.

5. Unfair Competition. — We have seen how the great combinations and monopolistic enterprises are in a position to effect economies through efficiency in the technique of production, in procuring their raw materials and in marketing their finished products. They combined not primarily to secure the advantages of large scale production for themselves and the consumer, but sought rather to acquire a monopolistic command over the industry in which they operated. Most of them have failed to attain their goal. Some were checked through the application of the anti-trust laws and others met with insurmountable practical difficulties. The only advantages over competitors that they enjoyed were chiefly those inherent in large scale production, but these were also attainable by their smaller competitors. Great size, huge fixed charges and burdensome administrative expenses bore heavily upon them. Under these conditions, the benefits that combination gave them at the outset were rapidly being swallowed up by the greater costs of doing business. They soon began to fear their competitors and resorted to many questionable business practices to suppress them. Many of these big concerns were repeatedly hauled before the courts to answer charges of unfair competition that were launched against them, and were usually found guilty. In fact, so general did this practice become that congress, in 1914, gave specific attention to this problem in the Clayton Act, supplementing the anti-trust legislation, and in the act creating the Federal Trade Commission. A number of the states also have adopted similar protective legislation enforceable through fines and imprisonment.

What constitutes unfair methods of competition, such as are contemplated by these acts, has become fairly well established through court decisions. An analysis of these

decisions has made it possible to classify them by types such as those given below.¹⁸ While this is by no means a complete list, it will, nevertheless, serve to illustrate in a general way some of the unfair practices that have been extensively employed by our larger business concerns to entrench and maintain themselves in a commanding position in their respective industries.

(a) *Local price cutting* stands at the head of the list. It has been used effectively by concerns that have a market which extends over a wide geographic area. They can cut the price at one point and recoup their losses by slightly raising it at other points, and thus crush their competitors one after another. It appears at one time to have been the favorite practice with the Standard Oil Company and with E. I. du Pont de Nemours and Company, the so-called Powder Trust.

(b) *Bogus Competing concerns* in the form of owned or controlled companies have also played their part. They are easily established and operated through the holding company organizations. The American Tobacco Company, the Powder Trust, the National Cash Register Company, used them to break down competition, and it was one of the few illegal practices indulged in by the conservative International Harvester Company.

(c) *Fighting instruments* is a term used to designate a product or appliance that is sold or operated at a loss for the definite purpose of breaking down a competitors' business. The American Tobacco Company used its "Battle Ax Plug" in this way, the Eastman Kodak Company a certain photographic print paper, the Waltham Watch Company one of its cheap watches, and even the big ocean

¹⁸ Dr. W. H. S. Stevens in a little book entitled "Unfair Competition" has worked out an excellent classification and description of these practices from court decisions upon which the one here given is largely based. Case references may be found in this work.

and river transportation companies maintained vessels which could be put into service to prevent the establishment of independent competing lines.

(d) *Exclusive and restraining contracts*, similar to those described as factors' agreements, also are unfair practices. They lead to a great deal of legislation because they are so frequently used in conjunction with patented commodities.

(e) *Rebates and preferential contracts* have been extremely common, and are used either individually or jointly. A fine of \$29,000,000 was at one time imposed by a Federal District Court upon the Standard Oil Company for accepting rebates from a railway company, but the decision was subsequently reversed. Nevertheless, this was one of the favorite illegal practices that led to the passage of railway rate and anti-trust legislation, and it was quite common prior to 1890 and still crops up occasionally in modified form.

(f) *Exclusive control of machinery used in manufacturing processes*, frequently called *engrossing*, has also been charged against some of our big business establishments. It is secured either through contracts requiring the manufacturer of the equipment to sell his whole output to the controlling concern, or through control of the patents giving the exclusive right to manufacture. The American Can Company, the Eastman Kodak Company and the Standard Envelope Company are reported to have prevented competition from springing up by this means.

(g) *Black listing and boycotting* have been very popular among lumber dealers who sought in this way to prevent price cutters from securing a supply of lumber. They have also been common in other fields of enterprise and have resulted in many prosecutions.

(h) *Intimidation and interference* were among the methods employed by the National Cash Register Com-

pany, the Shredded Wheat Company and others. Threats to cut off the supply of commodities to dealers, undermining the morale of competitors in order to induce them to sell out, fomenting strikes in the plants of competitors and hounding them with lawsuits, are some of the practices that come in this class.

(i) *Manipulation of the markets* has been indulged in, in order to force down the price of raw materials and to force up the price of finished products. The packers have been charged with inducing shippers of live stock to send their stock to yards that were already over-supplied. The butter producers of the middle West used "wash" sales to cover their price manipulations.

6. Monopoly and Combinations in Restraint of Trade.—The monopoly problem is subject matter for a course in itself. It is a problem that is constantly before the business public and one of prime importance. It is the anathema of American business. But after all, it is merely a matter of degree of industrial or commercial control, and the problems that it presents are chiefly those that have already been discussed, but in a somewhat more intensified form.

The growth and development of monopolies follows in general the same methods that lead to the development of large scale enterprises and combinations. They present no new features of organization but only a question of policy. While it is one of the cardinal rules of English, as well as American common law, that a state of free competition is the ideal state, this point of view is by no means universal. In Germany and other European countries, monopolies have been accorded legal sanction and exist in large numbers, more or less under government control and supervision. Even in America, the attitude toward them, influenced as it is by the forces of economic development, has undergone a gradual change from absolute condemnation to one of discrimination between "good" and "bad"

trusts, and the application of the "rule of reason" by the courts in interpreting the anti-monopoly acts. However, this problem is not one that falls properly within the scope of this work.

The many evils of our system of business organization, its weaknesses, the malfeasances and manipulations that have here been discussed cannot but leave an unfavorable impression. To one who comes into constant contact with this dark side of American business life the picture is indeed depressing. It is this aspect of business that has led Mr. Samuel Untermyer, who has acted as attorney for many investigating committees and has prosecuted many charges of violation of the law against big business concerns and their managers to characterize our corporation system in the following words:¹⁹ "Our corporation laws are without exception the loosest, most unjust and inadequate, and in every way the worst with which any civilized nation is afflicted. They are a snare to the investor, minorities are helpless, they offer a premium upon dishonesty and furnish the safest and most fruitful field to the criminally disposed exploiter for the practice of fraud and oppression upon the public. Every safeguard that other countries have thrown about their citizens has been rejected by us. From the birth to the death of the corporation the system is utterly wrong and designedly so."

This is surely a pessimistic view, and it is not without some foundation. The evils have been recognized. They have for years been well known. Remedies have frequently been proposed, but these have usually failed because of lack of interest and insufficient support on the part of the general public. Nevertheless, laudable efforts have at times been made through the passage of remedial legislation to correct these evils and abuses. These will be briefly considered in the closing chapter.

¹⁹ From an address appearing some years ago in the *Lawyer Citizen*.

CHAPTER XXI

PRESENT AND PROPOSED REGULATION AND REFORM

FROM the preceding chapters, we have seen that there are at present many regulatory measures in the statutes of our states and of the federal government. Nevertheless, in spite of these many statutes the situation is not encouraging. Many of the state laws are poorly enforced, and the federal laws are confined largely to matters of interstate commerce. Before considering what should be done to suppress the many evils and abuses of the system, it is well to review briefly some of these state and federal laws.

STATE REGULATION AND CONTROL

Much has been done by state legislatures and constitutional conventions for the protection of the public, the stockholder and the creditor of the corporation. A few states have attacked the problem in a spirit of fairness and justice. But in most instances these regulatory measures stand as isolated attempts rather than as well conceived parts of a complete and orderly system of reform.

Corporate Control. — The all important problem of corporate control has received considerable attention. A few states have constitutional provisions prescribing voluntary or compulsory use of the cumulative system of voting at the election of directors, thus seeking to assure a sizeable minority of proper representation on the board of directors. Many others have provided for the same thing by statute. The evil of the long-time proxy has been recognized and met by requiring that a proxy is valid only if granted within

a period of a few months, or a year, before the election at which it is to be used. A number of states have even recognized the danger of the voting trust as a means of divesting the stockholders of the proper exercise of their voice in the management and direction of the corporation, and have limited the life of such trusts to a period of five years. But, on the other hand, the majority voting system still prevails and in a few states the bondholders are given voting power.

Responsible Management. — To secure responsible management by directors most of the states have passed laws declaring directors to be liable for all damages resulting from wilful acts or culpable negligence. A few have even gone as far as to provide for penitentiary and jail sentences for directors who are guilty of violations of the law. Special attention has been given to the question of the declaration of illegal dividends. In practically every state are found statutes prohibiting the declaration of dividends that will impair the capital of the corporation or that will render it insolvent. But very seldom do they go further than that. Here and there, we find isolated cases where directors are required to reimburse the corporation for illegal dividends, and others, where they are made liable for certain debts of the corporation incurred during their term of office. Nevertheless, the control over the board of directors is left largely to by-law provisions, and in some of the states the directors still have the power to change the by-laws, thus making the rules for the game as they play it. Even the restrictions concerning dividends are discounted by the courts, who have held that the corporation may keep a separate account of income and capital, so that even though the capital depreciates, dividends may still be declared if there have been earnings.

Capitalization. — The subject of capitalization also has received some attention. Some of the states have attacked

excessive watering by prescribing that a certain amount of the authorized capital stock must be subscribed and paid in before the charter will vest. But these requirements still are inadequate, for they range from 10 to 50 per cent of the total authorized capital stock. Some attempt has also been made to prevent the sale of stock for less than its par value, and to require that property and services obtained in exchange for stock must, at a fair valuation, be equal to the par value of the stock given in exchange. Other states have dismissed the whole question of par value by permitting the issue of stock without par value. A number of state constitutions have provisions affecting the issue of bonds, usually requiring that bonds shall be issued for real value only, and declaring bonds issued for a fictitious value to be void. Many states also have statutory limitations on the amount of bonds that a corporation may issue. In some instances, the maximum bonded indebtedness that may be incurred must be stated in the charter; in others it must not exceed the amount of the capital stock; in others it must not exceed 50 per cent thereof, and in a few it cannot exceed one half of the value of the assets.

Some attempt has also been made to protect the stockholder against an issue of bonds by the directors. Thus, we find in perhaps a dozen states that the consent of two-thirds or three-quarters of the stockholders is necessary to authorize bond issues, and in others there are restrictions and limitations on the issue of convertible bonds. But in most of the states a mere majority vote is sufficient, while in others the directors have power over this important matter.

Systematic Reform.—As before stated, the measures described above are more or less isolated instances where a single problem has received attention. There have been a few attempts by states to effect a general revision of the

the corporation laws with a view to systematizing their reform measures. This has been the case in Missouri and New Hampshire where excellent laws are now in force. However, such general reforms are of little avail unless they are instituted by all or at least a great majority of the states. Under present conditions incorporators avoid the states where strict laws prevail and flock to those where incorporation is cheap, where the powers granted are broad and where there is a minimum of regulation.

The "Seven Sisters" of New Jersey.—In the above connection we need but call to attention the experience of the state of New Jersey with its corporation reform of 1913, commonly known as the "Seven Sisters" laws. In 1908, a commission was appointed to prepare a report on a proposed revision of the corporation laws of that state. This report sustained the existing system by saying "that the prejudice against corporations, common in other communities, hardly had an existence here; that the legislature did not amend the revised statutes recklessly; and still more important, that the courts of this state were conservative, reliable and just, in supporting the rights of property, and especially learned in the great questions of equity law so constantly brought into play in the management of corporations. Furthermore, the law was not lax in its terms nor in its interpretation by the courts. It was liberal, fair and sound." But in his message to the New Jersey Legislature in 1912, Woodrow Wilson, who was then governor of that state, attacked these selfsame laws in the following words: "The corporation laws of this state are notoriously in need of alteration. They are manifestly inconsistent with the policy of the people in the all important matter of monopoly, to which the attention of the whole nation is so earnestly directed. . . . The laws of New Jersey as they stand, so far from checking monopoly actually encourage it. They explicitly permit every corpora-

tion formed in New Jersey, for example, to purchase, hold, assign and dispose of as it pleases, the securities of this or that corporation and to exercise at pleasure the full rights of ownership in them, including the right to vote."

Accordingly, a set of seven bills was drafted and subsequently passed, comprising chapters 13 to 19, inclusive, of the Session Laws of 1913. The first of these chapters was a strict anti-trust law. The second applied strict rules to the valuation of property exchanged for stock and provided also that the stock of another corporation could be purchased only when the property of that corporation was "cognate in character and use to the property used, or contemplated to be used," by the purchasing corporation in the direct conduct of its proper business. The third made it unlawful to sell any commodity or render any public service at a lower rate in one section of the state than in another. The fourth made it a misdemeanor to organize or to operate a corporation with intent to use it directly or indirectly in restraint of trade or in acquiring or fostering a monopoly. The fifth struck out the famous clause empowering corporations to hold and vote the stock of other corporations. The sixth provided that no corporations previously or subsequently organized should, with certain limited exceptions, such as to provide for employees benefit funds, purchase or hold stock, bonds or other securities in any other corporation. The seventh provided that before any merger of corporations could be made, approval must first be obtained in writing from the Board of Public Utility Commissioners.

The effect of these laws was felt immediately. Revenues from corporation franchise taxes began to fall off and the granting of new charters followed suit. Delaware took the place of New Jersey as the home of the American corporations. Under these conditions, the first counter attack was not long delayed. In 1915, the power of purchasing stock

and bonds for investment purposes was restored. In 1917, the third and sixth of the "Seven Sisters" were disposed of by repeal and the second was amended. It was provided that any corporation formed under any law of this state might purchase stock of any other corporation under certain liberal definitions and restrictions. In 1920, the fourth of these laws, therefore remaining unaltered, was repealed, and additional laws were passed reducing taxes and fees of incorporation, providing for the issue of non-par value shares and for the evaluation and purchase of shares of a dissenting stockholder upon the merger or consolidation of two or more corporations.

Thus, was this laudable attempt at reform engulfed in a wave of reaction. It seems a hopeless task for the states to effect any lasting improvement in the laws governing corporate organization so long as they act individually. Only through joint action and the adoption of uniform laws can it succeed. Some measure of progress has been made in this way, particularly through the adoption of the principle of the so-called "blue sky" laws and the Uniform Stock Transfer Act.

"Blue Sky" Laws. — The general laws passed by the states seeking to prevent fraud and misrepresentation in respect to securities offered for sale within their jurisdiction are called "blue sky" laws. They are more or less alike in principle but differ greatly in the procedure prescribed to secure enforcement. One of the earliest of these laws was enacted by the state of Kansas. This law requires that every corporation, co-partnership and association, with certain exceptions such as banks, trust companies, etc., which sells or negotiates for the sale of any stocks, bonds or other securities in the state shall pay a small fee and file with the bank commissioner: (1) A statement showing in full detail the plan upon which it proposes to transact business; (2) a copy of all contracts, bonds or other instruments

which it proposes to make with or sell to its contributors; (3) a statement which will show the name and location of the investment company; (4) an itemized account of its actual financial condition and the amount of its property and liabilities; and (5) such other information touching its affairs as the bank commissioner may require. The bank commissioner is then directed to ascertain whether the company is solvent and whether it intends to do business in a fair and lawful manner; and, if in his judgment, it promises a fair return on the investment he may license it to carry on dealings in securities within the state. Thereafter, every investment company thus licensed must file an annual report in such a form as may be prescribed by the bank commissioner. Severe penalties are imposed for violations of the provisions of the act.

Other laws, such as those of New York, Maryland and a large number of other states do not prescribe a licensing system but merely empower the attorney-general, or some other state official, to investigate, either upon complaint or his own initiative: (1) The issuance, sale, promotion, negotiation, advertisement or distribution of securities where there appears to be a purpose to defraud or to obtain money or property by means of any false pretense, representation or promise; (2) where there is a suspicion that fictitious or pretended purchases or sales of securities are made or contemplated; and (3) where there is suspicion that dealings in securities are fraudulent or in violation of the law. If the attorney-general finds that the law has been, or is about to be, violated he may apply to the supreme court for a restraining injunction, and if this is not observed he may proceed with civil or criminal prosecution.¹

A considerable number of states have laws that regulate the purchase and sale of a very limited class of securities.

¹ The Maryland law of 1921 is given in Part VI, pp. 589-592.

These are patterned after, but are not true "blue sky" laws.

Uniform Stock Transfer Act.—In order to bring uniformity into the rules and regulations governing the transfer of title to shares of stock a law called the "Uniform Stock Transfer Act" was prepared some years ago and submitted to the several state legislatures for enactment. At the present time about one-third of the states have incorporated it in their statutes. It sets forth in great detail rules for delivery, indorsements, title, surrender and transfer of certificates, and the effect thereon of fraud, duress, mistakes, revocation, death or incapacity and lack of lawful consideration. Among the states that have adopted this act are Massachusetts, New York, Pennsylvania, Ohio, Maryland, Rhode Island and Michigan.

FEDERAL LEGISLATION

Federal legislation, in so far as it relates to the ownership organization in business, is naturally limited in its scope. The federal government is one of delegated powers only, and any powers of regulation over the business ownership organization must be expressly granted to it in the constitution of the United States.

It is specifically authorized to provide and to maintain a uniform system of currency, and to regulate commerce between the several states and with foreign nations. Under the former clause the United States chartered and maintained two United States Banks, the first during the period from 1796 to 1816 and the second from 1816 to 1836. Under the same clause it also provided, in 1862, for the formation and operation of the National Banks which were superseded by the Federal Reserve Banking System in 1911. However, it is under the interstate commerce clause that most of the congressional legislation relating to ownership organizations in business has been passed. In

general, this legislation may be grouped under two heads, namely, (1) that which deals primarily with transportation and (2) that which seeks to prevent monopoly and to preserve competition, commonly known as "anti-trust" legislation.

The Interstate Commerce Commission Act of 1887.— This act has to do chiefly with the regulation of railway freight and passenger rates and specifically prohibited the pooling of aggregate or net earnings. It also provided for the appointment by the President of an Interstate Commerce Commission of five members with a term of office of six years. The commission, among other things, is authorized to require of each carrier an annual report containing detailed information on capitalization, equipment, labor, receipts, operating and other expenses and a statement on financial operations, including an annual balance-sheet. The act as amended, in 1893, also gave the commission compulsory power of investigation.

The Elkins Act of 1903.— This was apparently intended to protect both the public and the railroads against the monopolistic industrial combinations which brought pressure to bear upon the railroads for preferential treatment. It specifically made corporations as well as their agents liable for violations of the interstate commerce laws, whereas the older laws made the agents alone liable.

The Hepburn Amendment of 1906.— This act extended the scope of the interstate commerce laws to express companies, sleeping-car companies and pipe lines for the transportation of oil or other commodities, except water and gas. It also empowered the commission to prescribe a uniform system of accounts for all railroads engaged in interstate commerce.

The Transportation Act of 1920.— During the war the railroads together with other transportation facilities were taken over and operated by the government. After the ces-

sation of hostilities many suggestions were made and plans formulated as to what should be done with the railroads. There was a strong sentiment that they should be retained by the government, and a plan known as the Plum Plan, even proposed that they should be turned over to the employees who should guarantee their former owners a definite return on their investments. In 1920, two bills were introduced into Congress, one by Senator Cummins and the other by Representative Esch, each of which was passed; respectively by the Senate and the House. As the bills did not agree on many points they were referred to a conference committee, which thereupon prepared the bill which was afterwards approved by both houses and signed by the President. This law is now commonly known as the "Transportation Act of 1920." In addition to providing for regulation, assuring the railroads a return of 6 per cent on a fair valuation of their properties for a period of two years and establishing a Railroad Wage Board, there are certain provisions relating to organization. The Cummins Bill provided for the compulsory consolidation of the railway companies into not less than 20 nor more than 30 great systems. In the final measure, this compulsory feature was eliminated, but the Interstate Commerce Commission was directed to "prepare and adopt a plan for the consolidation of the railway properties of the continental United States into a limited number of systems." Competition should be preserved as fully as possible and the several systems should be so arranged that they could compete with one another on about equal terms in the matter of cost of transportation, value of property, etc., in order that uniform rates might prevail. The Commission is now at work on its plan for consolidation, and it is highly probable that a law providing for compulsory combination will be submitted to Congress in the near future.

The difficulty experienced in forcing railroads to com-

pete coupled with the fact that they render a necessary public service that must, under any circumstances, be maintained is certain to force a reorganization that will in no small degree affect the independence and freedom of private ownership. The government has, by no means, come to a final determination as to what the ownership organization in this important industry shall be.

Federal Anti-Trust Legislation. — Contrary to the general impression, anti-trust legislation was first inaugurated by several of the states before the federal government took up this problem. In Kansas,² Michigan, and North Carolina such laws were enacted as early as 1889, and a number of other states followed this lead in the following year, at which time the famous Sherman Anti-Trust Law was incorporated into the federal statutes.

The Sherman Anti-Trust Law of 1890. — The nature of the conditions which led to the enactment of this law by Congress have already been sufficiently indicated and need not be repeated here. The law itself is very short and concise, and its meaning at the time of its passage seemed to be quite clear.³ Nevertheless, it has been amended on several occasions to correct weaknesses and to clarify certain doubtful points. The first section declares "every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations" to be illegal and makes anyone who enters into any such contract, combination or conspiracy guilty of a misdemeanor punishable by fine or imprisonment or both. Section two declares it to be a misdemeanor "to monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of trade or commerce" that might fall under the interstate commerce clause. Section three de-

² A reprint of this Kansas law is given in Part VI, pp. 588-589.

³ The act is given in full in Part VI, pp. 586-588.

finer more clearly just what commerce shall be within the scope of the act. Sections four and five provide for the enforcement of the act. Section six provides that any property in course of transportation in violation to the act shall be subject to forfeiture to the United States. Section seven authorizes anyone who has sustained injury or damage by virtue of a violation of the act to recover "three fold the damages sustained, and the costs of the suit, including a reasonable attorney's fee." The last section defines the word "person" or "persons" to include all corporations and associations.

Under this act the federal government waged its war against monopolies and combinations in restraint of trade. Since its enactment, the courts of the United States from the district courts to the Supreme Court, have rendered hundreds of decisions. Under it, the Standard Oil and Tobacco combines, the Northern Securities Company, and a great number of others of like character were dissolved in a desperate attempt to restore a state of free and open competition. But it was soon found that the law was not comprehensive enough, and it has been amended on several occasions.

The Anti-Trust Amendments to the Wilson Tariff Act of 1894. — The question of trusts again came up in Congress during the hearing on the proposed tariff revision in 1894, with the result that the Wilson Tariff Act, passed in that year carried a provision declaring every "combination, conspiracy, trust, agreement or contract made by or between two or more persons or corporations either of whom is engaged in importing any article from foreign countries into the United States" to be illegal when such an act is intended to operate in restraint of lawful trade, or free competition or to increase the market price of any article imported or any manufactures into which the article enters or is intended to enter. This law was again amended in 1913 to correct certain defects.

The Federal Trade Commission Act of 1914.— Experience with the Sherman Act had shown that one of the greatest obstacles standing in the way of its enforcement was the absence of any permanent body which might collect evidence of violations and then frame plans whereby the evils might be corrected. It left the collection of evidence in the hands of the Department of Justice, while the decrees of dissolution had to be drawn up by the courts. This placed an exceptionally heavy burden of responsibility upon both of these important divisions of the government. The problem received the attention of congress, which, in 1914, enacted the bill creating the Federal Trade Commission.

This act provides for appointment, by the President with the advice and consent of the Senate, of five commissioners for a term of office of five years, not more than three to be of the same political party. The commission is empowered to choose its own chairman. The act specifically declares "unfair methods of competition" to be unlawful and directs the commission to prevent their use, empowering it to demand summarily the discontinuance of the practices and to bring suit in the circuit courts of the United States to force compliance.

Certain additional powers also granted to the commission pertain to all business that falls under the interstate commerce clause except that of banks and common carriers.

These are as follows:

(a) To gather and compile information, and to investigate from time to time the organization, business, conduct, practices and management of any corporation engaged in commerce, except those above excluded.

(b) To require by general or special orders, corporations engaged in commerce to file with the commission in such form as the commission may prescribe annual or special, or both annual and special, reports or answers in writing to

specific questions, furnishing to the commission such information as it may require as to organization, business, conduct, practices, management and relation to other corporations, partnerships and individuals. The commission may require such reports to be made under oath.

(c) To make investigations, upon its own initiative, of the manner in which any decree made by the courts to prevent and restrain any violation of the anti-trust acts is being carried out. The Attorney-General may also call upon the commission for the same service.

(d) Upon the direction of the president or either house of congress to investigate and report the facts relating to any alleged violations of the anti-trust acts by any corporation.

(e) Upon the application of the Attorney-General to investigate and make recommendations for the readjustment of the business of any corporation alleged to be violating the anti-trust acts in order that the corporation may thereafter maintain its organization, management and conduct of business in accordance with law.

(f) From time to time to make public such portions of the information obtained by it, except trade secrets and names of customers, as it shall deem expedient or in the public interest; and to make annual and special reports to congress and to submit therewith recommendations for additional legislation; and to provide for the publication of its reports and decisions in such form and manner as may be best adapted for public information and use.

(g) From time to time to classify corporations and to make rules and regulations for the purpose of carrying out the provisions of the act.

(h) To investigate, from time to time, trade conditions in and with foreign countries where associations, combinations or practices of manufacturers, merchants, or traders, or other conditions may affect the foreign trade of the

United States, and to report to congress thereon, with such recommendations as it deems advisable.

Further provisions of the act deal largely with the filing of suits and the conduct of trials and hearings.

The Clayton Act. — At the time that the Federal Trade Commission Act was under consideration by Congress, ways and means of strengthening the Sherman Act were also taken up. The reports of the Pujo Commission on the so-called "Money Trust" had brought to light new problems of combination that involved the big banking and financial interests, and the problem of unfair competition had assumed threatening proportions. To meet these old and new problems Congress, in 1914, enacted the Clayton Bill.

This law declares it to be unlawful to discriminate in price between different purchasers of commodities where the article is of the same grade, quality or quantity, or to fix prices of patented or unpatented articles, or to use discounts or rebates in order to force purchasers or dealers not to handle or buy goods of competitors, where the effect of such acts is substantially to restrain or lessen competition. However, it specifically exempts labor, agricultural, or horticultural organizations, formed for the purpose of mutual help, and not having capital stock or being conducted for profit, from the operation of the anti-trust laws.

It further limits the scope of control that a holding company may exercise over its subsidiaries in that it forbids the acquisition of the whole or part of the capital stock or share of capital of another corporation where the effect may be substantially to lessen competition, to restrain commerce or to create a monopoly, or where the use of such stock by the voting or granting of proxies or otherwise may have the same effect. But these two prohibitions do not apply to the ownership of stock purely for purposes of investment,

nor to the formation of subsidiary corporations for the carrying out of the lawful purposes of the parent, or to common carriers in acquiring feeders for their main lines or in acquiring control over non-competing independent lines.

The act also strikes at interlocking directorates in banks, banking associations or trust companies of certain limited classes, namely, such as are organized under the federal banking acts and have deposits, capital, surplus and undivided profits aggregating more than \$5,000,000, and prohibits a director, officer or employee of a state bank of like size from becoming or being such in a federal bank.

A similar provision against interlocking directorates applies to corporations, other than banks and common carriers, whose capital, surplus and undivided profits aggregate more than \$1,000,000 where the effect would be to eliminate competition.

Misapplication by any president, director, officer or manager of the funds of any firm, association or corporation engaged in commerce as a common carrier is made a misdemeanor; and common carriers are also restricted in their dealings in securities, supplies or articles with partnerships, firms, associations or corporations in which they have officers or directors.

The act grants the federal courts wide latitude in the use of temporary restraining orders and injunctions; and provides, furthermore, that the acts of any corporation in violation of the anti-trust laws are also the acts of the individual directors, officers or agents who authorize, order or do the acts. The usual penalty of a fine not to exceed \$5,000 and imprisonment for not exceeding one year or both in the discretion of the court is provided as a means of enforcement.

The Webb Act of 1918. — During the war it was felt that that application of the Sherman Law and its amend-

ments to goods exported to foreign countries was a great obstacle to the development of America's foreign trade. This restriction was removed in 1918 by the enactment of the Webb Bill by congress. Under this act "goods, wares, or merchandise exported, or in the course of being exported from the United States or any Territory thereof to any foreign nation" do not come under the anti-combination or monopoly restrictions of the anti-trust laws. It specifically permits such combination to be formed under the stipulation that it "shall file with the Federal Trade Commission a verified statement setting forth the location of its offices or places of business and the names and addresses of all its officers and of all its stockholders or members, and if a corporation, a copy of its certificate or articles of incorporation and by-laws, and if unincorporated, a copy of its articles or contract of association," and thereafter to make a similar annual report to the commission. The commission is directed to see to it that these export combinations do not sell goods within the country or in any other way violate the anti-trust acts.

Within a few years hundreds of export combinations were formed under the act but with the decline in the foreign trade of the United States many of them have since ceased to function.

The War Finance Corporation Act.—Under its war powers Congress greatly extended its authority and control over ownership organizations. The War Finance Corporation Act, passed in 1918, sought to accomplish two things. First, it created a corporation with a capital of \$500,000,000 for the purpose of extending loans to industries that were necessary to the prosecution of the war and to federal banks. It might also issue bonds up to 75 per cent of the par value of certain government securities that it had acquired as security in support of loans. The stock of this corporation was all owned by the United States Govern-

ment. Second, it created a "Capital Issues Committee" and provided "that the Committee may, under rules and regulations to be prescribed by it from time to time, investigate, pass upon, and determine whether it is compatible with the national interest that there should be sold or offered for sale or for subscription any issue, or any part of any issue, of securities hereafter issued by any person, firm, corporation, or association, the total or aggregate par or face value of which issue and any other securities issued by the same person, firm, corporation, or association since the passage of this Act is in excess of \$100,000." Shares of no par value were to be deemed to have a par value of \$100 each. Borrowings in the ordinary course of business, refunding or renewal of loans, resale of certain classes of securities, securities issued by railroads and bonds issued by the War Finance Corporation were exempt from the operation of this part of the act.

The act was to continue in existence for a period of ten years, or six months after the end of the war.

From this act it is at once seen that the federal government may have much greater power of regulation over ownership organizations than it has deemed it wise to exercise under normal conditions. But it is open to question whether the broad powers of control granted to the Capital Issues Committee as a war measure would be equally valid under conditions of peace.

OUR FUTURE POLICY

The satisfactory regulation of ownership organizations in business in this country is by no means a simple and easy problem. It is now generally recognized that our system of corporate organization, which constitutes the most important element of our ownership system is in great need of reform. Nevertheless, there is great difference of opinion as to what should be done, or how it should be done and who should do it.

What Should be Done.—In the first place, it must be recognized that five distinct classes have interests at stake in this matter, and furthermore, that the interests of these classes are more or less opposed. They are the promoters, the financiers, the stockholders, the creditors and the general public.

The promoters desire little, or no regulation. Complete freedom of action is to their advantage. As a rule, they are not interested in the success or failure of the venture after it has once been established, for their work stops at that point. Consequently, the less there is of regulation and control the greater is the opportunity in their profession. However, the professional promoters are not numerous nor important as a class and it is very doubtful whether they render a really valuable service to modern business.

The financiers, as we have seen, play an important role, not only in the formation and establishment of the modern large scale enterprise, but also in its subsequent operation. They are undoubtedly a necessary adjunct to the system. Their interests must be given full consideration. While it would seem that they should desire conservatism, experience has proved that they too frequently enter willingly into agreements to finance highly speculative undertakings in the hope of being able to dispose of their transitory interests in the enterprise to the investing public before the collapse comes. They make their largest profits out of propositions of this kind, when the underwriting is successful. Where it is unsuccessful they lose heavily. The history of a number of such failures has become public knowledge, with the result that the public, both justly and unjustly, has placed the blame on the Wall Street's financiers. They are being watched closely by the public at large and this, no doubt, has tended to make them somewhat more conservative than formerly. Then too, they are also heavily interested as stockholders, bondholders

and ultimate general creditors of the existing enterprises which might suffer from new promotions, especially from the speculative kind. Thus, on the whole, it would appear that the best interests of the financiers lie in a middle course, namely moderate regulation.

The stockholders, in view of the fact that their interest in the enterprise is essentially entrepreneurial in character, naturally desire full protection in their right of ownership and a full voice in the direction of the business. They hold merely an equitable interest in the business, for the claims of general and preferred creditors take precedence over theirs. Their share in the business decreases directly as the creditors' shares increase. It is, thus, no more than just that they should insist upon a guarantee of full power to decide upon the issuance of mortgage and debenture bonds. Furthermore, there is the question of majority and minority representation upon the board of directors. The ordinary method of voting denies a 49 per cent minority even a single place on the board and leaves that minority in the position of owners without a voice in the management of the business. The situation becomes still more intolerable where the law permits the use of unlimited proxies and of long-time voting trusts. We cannot therefore, be surprised at the strong and insistent demand of the stockholders for minority representation, assurance of control and conservatism in the use of bonds and other creditors' instrumentalities of organization.

The creditors' interests demand a sound and conservative policy not only in the method of administration but also in the formation and organization of business enterprises. The extension of credit, in general, is determined by a complex of the three factors; character, ability and net worth. The first two of these factors are essentially characteristics or qualities of natural persons, and thus, tend to lose their importance in the impersonal forms or organization where

those intrusted with policies of control and management are constantly subject to change. New stockholders may take the place of old and install new directors whose policies are unknown. The change may, thus, become detrimental to the interests of creditors who extended credit to the enterprise on the strength of the character and ability of those who were in control at that time. Because of the uncertainty of these two factors, the tendency has been to rely more upon the capital, or net worth, of the concern as a gauge of its right to credit. The creditors' interests demand that the earnings of the company be retained, or re-invested in the business instead of being distributed as dividends. In a measure they run counter to those of the stockholders, who desire large dividends. Conservatism is the chief demand of the creditor, he wants regulations that will prevent the quick change in business policy, that will prevent the mulcting of the business through large dividends, that will insure the value of the assets and that will prevent over-capitalization.

The general public's interests should naturally be identical with those regulations and conditions that will make it possible for industry to develop along the most advantageous economic lines. But the public does not always know what is best, and in making up its mind it appears to be perfectly satisfied to let its legislative representatives force its demands into a political, rather than an economic mold. The apathy of the public in matters concerning the mode of formation, methods of finance, of administration and control of the business ownership organization is astounding. This passive attitude is due, in no small part, to the feeling of helplessness that has been engendered by the fact that any action seeking to attack the problem at its root must emanate from the state governments. These seem to be more intent upon deriving a large revenue from the sale of corporate charters than upon any constructive

measures that might prevent the flagrant evils and abuses now inherent in the system.

The evils that are the cause of complaint have been discussed. They are more or less clearly understood; and the remedy in most cases is as patent as the evil. The conflicting interests, however, remain an obstacle to be overcome.

How it Should be Done. — This is not so much a problem of choosing the proper legislative measures whereby the evils are to be corrected, but rather one of selecting a mode of procedure; that is to say, should it be done through regulatory measures imposed by statute or should the business world be left to work out its own salvation. In other words, should it be through a policy of government or state control or through one of "hands off" ?

The second method has been given a fair trial and has not proved to be to the best interests of the public at least in so far as the public is a judge of what is to its interests and what is not. It may, therefore, be dismissed without further consideration.

Granting, then, that the policy of government control should be continued, and perhaps extended, we are at once confronted by the question whether the several states or the United States should exercise this control. Up to the present time it has been very largely in the hands of the states, a circumstance that, in no small measure, has been responsible for the chaotic conditions that now exist, and that will in all probability continue so long as the several states follow a policy of competitive laxness and latitude.

Control by the federal government seems to be the only real solution of the problem. This may perhaps be best accomplished and made most effective by requiring incorporation under federal laws. This would, of course, not give the federal government the power of control over the personal ownership organizations and unincorporated as-

sociations and companies, but it would, nevertheless, be a great step in advance.

Federal Incorporation. — It has at various times been suggested that congress, without violating the United States Constitution, can force federal incorporation through any one or all of the following methods:

(1) By excluding from the channels of interstate commerce the articles manufactured or otherwise produced by state corporations.

(2) By prohibiting all corporations not chartered by congress from engaging in interstate commerce.

(3) By laying a prohibitive tax upon the interstate business transacted by state-chartered corporations.

(4) By denying the use of the mails to state corporations that engage in interstate commerce.

There is no doubt that the practicability as well as the constitutionality of some of these plans are open to question. The first, third and fourth of these plans, all involve more or less discrimination and would appear to come under the prohibition of the "due process of law" clauses contained in the Fifth and Fourteenth Amendments of the Constitution. Thus, it has been held that under these clauses the law must operate equally on all persons and that any classification adopted must be based upon a reasonable ground of distinction. It cannot be a mere arbitrary selection.⁴ This would leave the second plan as, perhaps, the most feasible.

Aside from these facts, all of these plans are predicated upon the federal government's power to regulate interstate commerce. One of the broadest definitions of interstate commerce is that given by Chief Justice Marshall in his decision in *Gibbons v. Ogden* ⁵ in which he said, "The sub-

⁴ Cases in point are: *Giozza v. Tiernan* (1893), 148 U. S. 657; *Gulf, etc., Railroad v. Ellis* (1897), 165 U. S. 150; *McCray v. United States* (1904), 195 U. S. 27.

⁵ 9 Wheat. 1, 189 (decided in 1824).'

ject to be regulated is commerce and . . . it becomes necessary to settle the meaning of the word. The counsel of the appellee would limit it to buying or selling, or the interchange of commodities. . . . This would restrict a general term, applicable to many objects, to one of its significations. Commerce undoubtedly is traffic, but it is something more — it is intercourse.” In further interpretation it has been held that it is traffic in or transportation of persons, property and ideas.⁶ But on the other hand, contracts for the issuance of insurance policies are not interstate commerce.⁷ It is, therefore, doubtful whether the interstate commerce clause would be comprehensive enough to give the federal government sufficient power adequately to control even the more important and larger business organizations in the country.

However, in a special message to congress, January 7, 1910, in recommending additional legislation to control trusts, President Taft said:

“Generally, in the industrial combinations called ‘trusts’ the principal business is the sale of goods in many States and in foreign markets; in other words, the interstate and foreign commerce far exceeds the business done in any one State. This fact will justify the Federal Government in granting a Federal charter to such a combination to make and sell in interstate and foreign commerce the products of useful manufacture under such limitation as will secure a compliance with the anti-trust laws. It is possible to frame a statute that while it offers protection to a Federal company against harmful, vexatious, and unnecessary invasion by the States, it shall subject it to reasonable taxation and control by the States with respect to its purely local business. . . .

“Corporations organized under this act should be prohibited from acquiring and holding stock in other corporations (except

⁶ *Covington Bridge Co. v. Kentucky* (1894), 154 U. S. 204; *Hanley v. Railroad Co.* (1903), 187 U. S. 617, 619; *Telegraph Co. v. Texas* (1881), 105 U. S. 460.

⁷ *Paul v. Virginia* (1868), 3 Wall, 168.

for special reasons, upon approval by the proper Federal authority), thus avoiding the creation under national auspices of the holding company with subordinate corporations in different States, which has been such an effective agency in the creation of the great trusts and monopolies. . . .

"The drafting of such a Federal incorporation law would offer ample opportunity to prevent many manifest evils in corporate management to-day, including irresponsibility of control in the hands of the few who are not real owners."

Judge Elbert H. Gary set down his ideas upon this subject in a bill drafted by him and submitted to the Senate Committee on Interstate Commerce at the request of that body.⁸ This bill provides for federal control by requiring every corporation, except common carriers, to secure a federal license to do interstate business and makes every such corporation subject to the regulatory provision of the bill so long as it retains such a license. Section 7 of this bill seeks to prevent over-capitalization and watered stock by requiring as a condition of the issuance of a license that "no stock of said corporation was issued except for cash or for property equal in value to the par value of the stock thus issued." To enable the corporation commission provided for in the bill to ascertain the reasonable value of property taken in exchange for stock the corporation was required to file with the commission a written statement signed and sworn to by the majority of the board of directors setting forth "(a) A full description of the property in payment for which stock was issued; (b) the number of shares issued in payment for said property and whether or not such shares have a par value, and if so, the aggregate par value of the stock so issued, or if not, then the number of shares so issued; (c) the names and addresses of the vendors of the property purchased or acquired by the cor-

⁸ The bill is reprinted in full by W. H. S. Stevens in *Industrial Combinations and Trusts*, pp. 548-557.

poration with the stock so issued and whether or not they, or any of them, were officers or directors of the corporation, and whether or not they, or any of them, were, to the knowledge of the signers of the statement, owners in their own name or otherwise of any shares of stock in the corporation, and if so, how many of such shares; (d) the terms of any agreement, verbal or written, for the transfer of such property to the corporation, and the parties to all such agreements, and particularly the amount paid as purchase money in cash or shares for such property, specifying any amount payable for good will and any and all amounts paid to each vendor; and in case any written contract has been made with said vendors, or any of them, a sworn copy thereof shall be filed with such statement; (e) in case the vendors of such property or any of it, are directors of the corporation or owners of any of its stock in their own names or otherwise, a statement of the prices paid by them for the property so sold or transferred to the corporation and copies of all the contracts by which the said vendors acquired the ownership or the control thereof."

It provides further, that all corporations licensed under the bill shall make annual and special reports to a corporation commission, and also gives this commission and several other government bodies full power of investigation with a view to enforcement of the act. It is by far the most comprehensive plan for federal control that has yet been proposed short of an amendment of the Constitution.

However, on summing up the situation, one cannot but come to the conclusion that any federal control over business ownership organizations that can be instituted under the existing constitutional provisions can be made to apply only to a limited number of establishments. The only real beginning to a solution of the problem is through amendment of the Constitution, and this should be given a fair trial before the possibility of government control is entirely discarded.

PART VI
SUPPLEMENTARY FORMS AND
DOCUMENTS

A. FORMS PERTAINING TO THE PARTNERSHIP

FORM 1.

PARTNERSHIP AGREEMENT

ARTICLES OF AGREEMENT made the sixteenth day of May One thousand nine hundred and twenty-one by and between

JOHN JONES of the City, County and State of New York, hereinafter called Jones,

THOMAS BROWN of the Town of Montclair, County of Essex, State of New Jersey, hereinafter called Brown, and

HENRY ROBINSON of the City, County and State of New York, hereinafter called Robinson,

Any of whom is hereinafter called "partner" and all of whom together are hereinafter called "partners,"

WITNESSETH as follows:

1. The said parties above named have agreed to become partners in business and by these presents do agree to be partners together under and by the name or firm of JONES, BROWN & ROBINSON, and at the City, County and State of New York to engage in and carry on the business of dealers in hardware, buying and selling hardware on their own account or on consignment or commission and generally to do in the scope or conduct of the business whatever ordinarily is done by dealers in hardware.

2. The partnership shall begin on the first day of June, One thousand nine hundred and twenty-one. To that end and purpose they will contribute capital as follows:

JONES the sum of Ten thousand Dollars (\$10,000).

BROWN the sum of Fifteen thousand Dollars (\$15,000).

ROBINSON the sum of Twenty thousand Dollars (\$20,000).

Of these contributions fifty per cent (50%) shall be made on the day named in this agreement for the partnership herein provided for to take effect. The remaining fifty per cent (50%) shall be made on the fifteenth day of July, One thousand nine hundred and twenty-one. The capital so contributed shall be used and employed in common by and between the partners as provided in this agreement, and generally for the support and management of the partnership business to the mutual benefit and advantage of the partners.

3. All gains, profits and increases that shall come, grow or arise from or by means of the partnership business, and hereinafter, of whatever nature, in this agreement called "profits" shall be divided among the partners in the following manner:

(a) The profits of the business shall be considered for the purpose of computing the division and distribution agreed on as of two classes. One class shall be that share of the profits to which the partners are entitled irrespective of their contributions to capital. This share is designated in this agreement as "profits of the first division." The other class shall be that share of the profits to which the partners are entitled by reason of their contribution of capital to the partnership business. This share last described is designated in this agreement as "profits of the second division."

(b) The shares of profits of the first division shall be computed as the following percentages of the total profits of the partnership business: Jones, thirty per cent (30%), Brown twenty per cent (20%), Robinson, fifteen per cent (15%).

(c) Of the remaining thirty-five per cent of the total profits of the partnership business comprising "profits of the second division" the share of each partner shall be computed, divided and distributed in proportion to the amount of capital each partner has contributed.

4. As among the partners losses shall be borne in proportion to the capital contributed. Losses shall be paid out of capital, but shall be made good out of subsequent profits of the partnership business before there shall be any accounting for profits to the partners. If at any time the capital is entirely exhausted in the payment of losses the partners shall be liable as to each

other in proportion to the total share of the profits, including profits of both divisions to which they are entitled.

5. Each partner shall be entitled to draw through the year Three hundred and fifty Dollars on the last day of each month on his personal account and no more, and shall be entitled to withdraw this sum so long as this agreement shall continue whether or not the business shows a profit.

6. On the death of any partner the surviving partners shall exhibit a statement of accounts as of the date of the deceased partner's death to the legal representative of the deceased as soon as practicable, but shall not be compelled to make any payment or an accounting for a period of eighteen months from such decease. The surviving partners may, however, at any time pay to such legal representative all or any part of the deceased partner's share. So long as any of the capital of the deceased partner shall remain in the business his legal representative shall be entitled to profits of the second division in proportion to the deceased partner's capital remaining in the business.

7. Representatives of a deceased partner shall not be entitled to any compensation or accounting for good-will, but surviving partners shall be entitled to the benefit of all the good-will of the business as of their own right. Surviving partners shall have a right, subject to and in accordance with the laws of the State of New York without compensation, to continue the name of a deceased partner as part of a firm name.

8. It is agreed by and between the parties hereto that there shall be kept at all times during the continuance of this agreement at the office of the partnership perfect, just and true books of account wherein the partners shall enter and set down the capital contributed and withdrawn, all money by them received, paid, laid out and expended in and about the business of the partnership, goods, wares and merchandise by them or any of them bought or sold, either for the account of the partnership or on consignment or commission, and all other matters and things whatsoever to the business and the management thereof in any wise belonging. Said books shall be used in common among the said partners, so that any of them may have access thereto without any interruption or hindrance of any other.

9. The partners once each year, as of the thirty-first of December, and as soon thereafter as reasonably practicable, shall make, yield and render each to the other a true, just and perfect inventory and account of all profits and increases by them or any of them made and of all losses by them or any of them sustained; and also all payments, receipts, disbursements, and all other things by them made, received, disbursed, acted, done or suffered in the partnership and business. When this account is made they shall and will clear, adjust, pay and deliver, each to the other, at the time, their just share of the profits, and pay and bear their just share of the expenses and losses so made as aforesaid. Further at the request of any partner such an accounting shall be made as of the thirty-first day of any March (March 31st) or the thirtieth day of June or September during the continuance of the partnership hereunder, and as soon thereafter as practicable; but on such an accounting no partner shall be entitled to the payment of any profits, nor so long as the partnership is solvent shall be called on to pay into the partnership his share of the expenses and losses. The representatives of a deceased partner, however, on calling for such an accounting may, as in this agreement above provided, withdraw the proportion of the capital to which they are entitled.

10. At all times during the continuance of their partnership the partners and each of them will not engage in any other business, but will give their attendance, and will use their and each of their best endeavors, and to the utmost of their skill and power exert themselves for their joint interest, profit, benefit and advantage and will truly employ their joint capital, and, until it is paid out on an accounting, the increase thereof, in the business aforesaid. No partner shall accept any office or employment, whether honorary or remunerative, without consulting the other partners or so many of them as may be reasonably available, and shall not accept it against the will of half or a majority of the partners.

11. All partners shall have an equal voice in the management of the business, but each partner so far as is possible and as is reasonable in the interests of the business shall consult the other partners. Especially no partner shall commit the partnership

to any transaction on its own account exceeding an amount of \$2,000 without consulting all the partners who may be reasonably available for consultation either personally or by communication by mail, telegraph or telephone; and such opportunity for consideration as may be consistent with the nature of the transaction shall be given. No such transaction shall be entered into unless all the partners who are reasonably available are unanimously in favor of it. In event of a disagreement among the partners as to any other transaction or business the will of the majority, or of the majority of those reasonably available for its consideration, shall prevail, and in the event that the partners available are equally divided the transaction shall not be entered into or the business undertaken or the change made.

12. No partner shall on his own account speculate in or in any way purchase stocks or other securities or commodities on a margin. And the parties hereby also mutually covenant and agree to and with each other that during the continuance of the partnership none of them shall or will indorse any note, or otherwise in any way become guarantor or surety for any person, persons, partnership, association or corporation whomsoever or whatsoever. Each partner shall at all times duly and punctually pay and discharge his separate and private debts and engagements, whether present or future, and keep indemnified therefrom, and from all actions, proceedings, costs, claims and demands in respect thereof, the partnership property and the other partners.

13. On the termination of this partnership the partners, each to the other, shall and will make a true, just and final account of all things relating to their business as partners, and in all things make a true adjustment in accordance with the terms of this agreement.

IN WITNESS WHEREOF, the parties hereto have, at the City, County and State of New York, hereunto set their hands and seals, the day and year first above written.

In the presence of:

James Blackman

JOHN JONES

THOMAS BROWN

HENRY ROBINSON

FORM 2.

NOTICE OF DISSOLUTION OF PARTNERSHIP

NOTICE is hereby given that the partnership subsisting between *Adam Jones*, Special Partner, *Alfred Brown* and *Henry Miller*, General Partners, under the firm name of *Adam Jones & Company* was this day dissolved.

(Dated)	(Signatures of Partners)
.....	<i>Adam Jones</i> <i>Alfred Brown</i> <i>Henry Miller</i>

The notice of dissolution is frequently accompanied by an affidavit by a notary public, such as the following:

STATE, CITY AND COUNTY OF NEW YORK, SS:

On this.....day of.....1921, before me personally appeared (names of partners), to me known and known to me to be the individuals described in and who executed the foregoing instrument, and they duly acknowledge to me that they executed the same.

.....*Notary Public.*

FORM 3.

NOTICE OF A PARTNER'S WITHDRAWAL

NOTICE is hereby given that.....on the....day of....., withdrew from the partnership existing between.....and....., under the firm name of All debts due to said partnership and those due by them have been assumed by the remaining partners, who will continue the business under the firm name of.....

(Dated)	(Signatures of Partners).....
.....	
	

B. FORMS PERTAINING TO SECURITIES— ISSUING ORGANIZATIONS

1. THE JOINT STOCK COMPANY

The forms and documents pertaining to the organization and operation of the joint stock company are fully as numerous and varied as those that pertain to the corporation. However, for the most part they resemble the corporate forms so closely that it would result in a great deal of duplication to reproduce them here. For this reason the specimens are confined to a single copy of articles of association.

FORM 4.

ARTICLES OF THE PIERCE FORDYCE OIL ASSOCIATION

A Joint-Stock Association

ARTICLES OF COPARTNERSHIP

Name.

We, whose names are hereto subscribed, do hereby form a Copartnership Association, to be known and styled

PIERCE FORDYCE OIL ASSOCIATION,

which shall continue in existence until the 2d day of April, 1960, unless sooner dissolved as herein provided.

Purposes.

The general purpose of said Copartnership Association is: To engage in the general merchandise of petroleum and the products thereof and other such articles as may be advantageously sold or handled in connection therewith; to purchase, own and mine lands supposed to contain or containing oils or other minerals and to

construct and operate refineries or other manufacturing plants for refining or reducing such oils or minerals and to engage in any other industrial, manufacturing, mining or merchandising enterprise or exploitation that may be determined by the board of managers appointed or chosen as hereinafter provided.

Capital.

The capital is three million dollars, divided into thirty thousand shares of one hundred dollars each, all of which has been paid in, by the subscribers hereto. The capital may be increased from time to time by increasing the number of shares and the admission of new members, as may be determined by a vote of the majority of the then shares at any meeting of the shareholders called pursuant to these articles of association or such by-laws as may be adopted hereafter by a majority of the shares.

Shares.

The certificates of membership shall be issued by the president of the board of managers and countersigned by the secretary of said board and shall be substantially the following form, viz.:

PIERCE FORDYCE OIL ASSOCIATION,

(*Copartnership.*)

Capital, \$3,000,000, or thirty thousand shares.

Member's Certificate of Interest.

This is to certify that.....is the owner of full paid share of beneficial interest in the Pierce Fordyce Oil Association, transferable on the books of the association by the owner thereof in person or by duly authorized attorney upon surrender of this certificate properly indorsed.

This certificate of interest is subject to the provisions and covenants contained in the articles of copartnership of the Pierce Fordyce Oil Association, dated the 2d day of April, 1910, and any amendment thereto and the by-laws of said association

and the provisions hereof. No member of said association or owner or holder of this certificate shall have any authority, power or right whatsoever to do or transact any business whatever for, on behalf of or binding on the association or any member thereof, and no member of this association shall be liable for any debts, covenants, demands or torts of this association beyond the amount of his shares.

This certificate shall be the sole and only evidence of membership in said association and shall be surrendered upon the call of the board of governors at any time to the association upon the payment or tender of payment to the amount of its face or par value and a premium of fifteen per cent thereof.

In WITNESS WHEREOF, the said association has caused this certificate to be signed by its duly authorized officers and to be sealed with the seal of the association this....day of....., 19.....

.....,
Secretary.

.....,
President.

Death of Member

The decease or insolvency of a member of the association shall not work a dissolution of it or have any effect upon the same, its operation or mode of business; nor shall it entitle his legal representatives or heirs or assigns, voluntary or involuntary, to any account or to take any action in law or equity or otherwise against the association, its members, officers, board of governors, trustees or its property or assets; but they shall simply and only succeed to the right of the deceased, to the certificate of membership and the shares it represents, subject to this agreement, the amendments thereto and the by-laws of the association, now or hereafter adopted.

Board of Governors

The entire affairs of this association shall be managed by a board of governors, consisting of seven members, each of whom shall own at least a certificate or certificates for not less than

ten shares, who shall be elected by a majority of shares held by members at a regular annual meeting of the certificate holders every two years after the expiration of the term of the first board of governors.

The first board of governors shall be composed of the following named persons, viz: H. C. Pierce, Samuel W. Fordyce, Samuel W. Fordyce, Jr., George T. Priest, Robert E. Moloney, Henry W. Allen, and John H. Holliday, who shall continue for the period of five years next ensuing the date of this agreement.

Each board shall elect its own president, vice-president, secretary and treasurer and may create such other offices, filling them by appointments and prescribing the duties appertaining thereto as they may deem wise, necessary or convenient to carry on the business of the association and may likewise fill any vacancy in its membership occasioned by death or resignation until the next election of a board of governors. The board may also fix the salaries of all officers, including its own members, and may remove any officer and fill all vacancies which may occur in any office.

The first board of governors shall appoint such a number of its members as it may deem proper, not exceeding three, as trustees, in whose name or names all investments and title to all property are to be made and held under a declaration of trust for and on behalf of this association.

The board of governors shall be held to be trustees for and on behalf of this association, and may in that capacity sue and be sued in any court of law or equity.

The board of governors shall have full power and authority in the conduct of the business of the association to borrow money and issue mortgage debentures therefor if deemed advisable, and any debt for money so borrowed or liability created shall be and remain until paid a lien upon all funds, moneys and properties there or thereafter belonging to or held in trust for this association in preference to the claims or claim of any shareholder as such.

(1) The board of governors shall have no power to bind the shareholders or members personally; and in every written contract or undertaking they shall enter into relating to the

business of this association, its property or any part thereof, reference shall be made to this agreement; and the person, firm or corporation so contracting with the board of governors shall look only to the funds and property, legal and equitable, of this association for the payment of any debt, damage, judgment or decree or of any money that may become due and payable in any way by reason of the contract or undertaking; and neither the board of governors nor the shareholders or members present or future shall be personally liable therefor or for any debt incurred or engagement or contract made by said board of governors.

(2) The board of governors may fix and regulate their own time and place of meeting and a majority thereof shall constitute a quorum and possess and exercise all the powers of a full board.

(3) The board of governors shall, whenever they may be so minded, convene all the registered share or certificate holders in general meeting without specifying the purpose thereof upon notice to that effect deposited in the post office at the place of the general offices of the association addressed to each shareholder at his registered post office address, ten days before the date of the proposed meeting; and the majority of the shares present or represented at any such meeting so called, shall have and exercise the right, power and authority of the entire body of share or certificate holders.

(4) The share or certificate holders shall meet annually on the second Tuesday of each year without further notice to consider the affairs of the association and transact such business as may then be inaugurated by them or that may be submitted for their consideration by the board of governors. At each meeting of the share or certificate holders, each member present or represented by duly accredited agent or attorney shall be entitled to cast as many votes upon any proposition as he may have shares of membership interest.

(5) At any meeting of members, by-laws may be passed or amended by a majority of those present or represented; and any amendment may be made to this agreement by a vote of three-fourths of those present or represented.

(6) The board of governors may from time to time declare and pay such dividends from the earnings of the association as they deem expedient.

OFFICERS AND THEIR DUTIES

President and Vice-President

The president, or in his absence the vice-president, shall sign all certificates of membership, preside at all meetings of the members of the board of governors and shall do and perform and render such acts and services as the board of governors shall prescribe and require and shall receive such compensation for services as may from time to time be fixed upon by the board of governors.

Secretary

The secretary shall countersign all certificates of membership and shall keep such minutes, records and books as the board of governors may require, attend all meetings of the board of governors and render such services as may be imposed upon him.

Treasurer

The treasurer shall perform such duties as the board of governors may impose upon him.

Title Trustees

The members of the board of governors appointed to hold the title to all property of the association shall at all times be subject to the orders of the board of governors who may at any time and for any cause remove any or all of them from office and appoint and devolve upon other members of the board of governors the duties and functions of the office. In the case of the death, resignation or other disability of any such trustee, the board of governors may fill the vacancy caused thereby.

This association shall continue for a period of fifty years from the date of the execution hereof unless sooner dissolved by the vote of the majority of membership certificates or shares.

IN WITNESS WHEREOF, we have hereunto set our respective signatures and attached our several seals this the.....day of April, 19.....

HENRY C. PIERCE,	(Seal).
S. W. FORDYCE,	(Seal).
SAMUEL W. FORDYCE, JR.,	(Seal).
GEORGE T. PRIEST,	(Seal).
ROBT. E. MOLONEY,	(Seal).
HENRY W. ALLEN,	(Seal).
JOHN H. HOLLIDAY,	(Seal).

2. THE CORPORATION

While the forms and documents used in organizing and operating the corporation exhibit almost an infinite variation, nevertheless, there are many forms that have become more or less standardized. In the selection of the forms that follow, care has been taken to avoid any peculiar or exceptional technical requirements.

Contract to Form a Corporation.—The contract between the incorporators is in the nature of a partnership agreement, and the status of the incorporators is that of partners until the purposes of the contract are fulfilled.

FORM 5.

GENERAL CONTRACT TO FORM A CORPORATION¹

(STATE OF ILLINOIS)

This agreement made this first day of November, A.D., 1909, by and between the undersigned, John Brown, William Burbank, Edward Cunningham, and Raymond Williams, all of the city of Chicago and state of Illinois.

¹ From Frank's *Science of Organization and Business Development*.

Witnesseth, That in consideration of the mutual undertakings and agreements of the parties hereto, as hereinafter set forth, and in further consideration of the sum of one dollar by each of the said parties to the other in hand paid (at the time of the execution hereof), the receipt of which is hereby severally acknowledged, the said parties to this contract hereby agree by and among themselves and with each other as follows, to wit:

First, that a corporation shall be formed by us under the laws of Illinois substantially as follows:

(a) The name thereof to be the Perfect Automobile Company.

(b) The capital stock of said corporation to be One Hundred Thousand (\$100,000) Dollars, divided into one thousand (1,000) shares of One Hundred (\$100.00) Dollars each, said stock to be all Common Stock of uniform character and usual form.

(c) The purpose of said corporation to be substantially for the manufacture and sale of automobiles and their parts.

(d) Said corporation shall have a Board of Directors consisting of five in number, who shall all be stockholders of record at the time of their election.

(e) The officers of said corporation shall be a President, Vice-President, Secretary, Treasurer, and General Manager.

(f) The location of the principal office to be at Chicago.

(g) The duration of said corporation to be 99 years.

Second, we hereby agree with each other, and the one with the other, that we will take the number of shares of the capital stock of said corporation set opposite our respective names hereunto subscribed, and will pay to the commissioners duly appointed by the Secretary of State of Illinois in that behalf, fifty (50%) per cent of the par value of the said shares so subscribed by us respectively at the time of holding the first meeting of the said subscribers to elect a Board of Directors for said corporation; and we further agree to pay the balance of our said subscriptions whenever called upon so to do by the Board of Directors of said corporation after the same shall be formed.

Third, we further nominate, constitute, and appoint..... as our agent (or attorney), and the agent (or attorney) of the said corporation so to be formed, to create or cause to be created the said corporation in accordance with the laws of Illinois and

this agreement, and to do and perform all things necessary to bring said corporation into legal existence; and we further authorize and empower our said agent (or attorney) to draw on the funds in the hands of the legally constituted officers or agents of said corporation, for the necessary expenses attending such incorporation, and we further agree that any and all contracts which our said agent (or attorney) may make in such matter shall be binding upon said corporation and also upon us jointly and severally.

In witness whereof, we, the undersigned, hereby severally bind ourselves, our heirs, executors, and administrators.

<i>Names</i>	<i>Addresses</i>	<i>Shares</i>	<i>Amount</i>

Option Agreements. — Option agreements are employed when the corporation to be formed is to take over certain properties or businesses in order to hold such properties, etc., until the corporation can be fully organized and act for itself. The agreements are usually executed between the owners of the properties as vendors and one of the incorporators of their agent or a promoter as vendee. The payment made to secure the option is usually forfeited in case the option fails.

FORM 6

OPTION ON BUSINESS AND PROPERTY

An agreement entered into this 18th day of April, 1916, by and between the Ellsworth Wagon Company, a corporation duly organized under the laws of the State of Illinois, party of the first part, and William F. Mead of Chicago, party of the second part.

For and in consideration of the sum of One Dollar paid said party of the first part by the party of the second part, receipt whereof is hereby acknowledged, and for other goods and valuable considerations, said party of the first part does hereby agree to sell to the said party of the second part, as a going concern, its entire business, factories and plant for the manufacture and sale of wagons, owned and operated by said party of the first part in the city of Chicago, Cook County, State of Illinois, including therewith all machinery, tools, and other property and appurtenances thereunto belonging, including all raw materials, manufactured products on hand, and all contracts relating to the purchase and sale of such materials and products; and also the good-will of said business and all trade-marks, brands, patent rights, licenses, etc., used therein and controlled by said party of the first part; excepting only moneys and bills and accounts receivable on hand at the time of sale; all of such property to be delivered free and clear from all liens, charges, encumbrances, taxes and assessments.

The price to be paid for said property shall be an amount Ten Thousand Dollars (\$10,000) in excess of the actual appraised value at the time of purchase, of said real and personal property, exclusive of good-will, as above set forth, and such amount shall be paid in cash at the time of transfer.

This option shall expire and be of no further effect on and after the 30th day of September, 1916, unless prior thereto said party of the second part, or his assigns shall, in writing, notify said party of the first part of his or their intention to exercise the same, and shall at that time deposit in the First National

Bank of Chicago, Ten Thousand Dollars (\$10,000) in cash as a guarantee of good faith and to apply upon the purchase of said property, and within such event the party of the first part shall within sixty days of such notice and deposit, transfer and convey said business and property by such deeds, conveyances, and assignments and other instruments as may be necessary to vest second part assumes no responsibility to purchase said property in said party of the second part or his assigns.

It is further understood and agreed that said party of the second part assumes no responsibility to purchase said property unless he or his assigns shall elect so to do by written notice and deposit in bank as afore provided, and that in case of assignment of this present instrument by said party of the second part, all its provisions shall inure to the benefit of, and run in favor of, and be binding upon his assignee or assignees in every respect as heretofore upon said party of the second part, and in case of such assignment said party of the second part shall be free from all liability hereunder.

In case of disagreement as to terms of this option or as to any matters connected with the exercise thereof, each party hereunto shall appoint an arbiter and the two so appointed shall appoint a third, and the three arbiters so selected shall be empowered to decide finally all matters of disagreement.

(Here follow the corporate signatures and the signature of the party of the second part.)

Option on Stock. — When a corporation whose stock is closely held by but a few persons is to be sold, the option is frequently for the purchase of the stock rather than the property of the corporation. If the purchase is made on behalf of another corporation, the latter must have the power to hold corporate securities. A common form is as follows:

FORM 7

OPTION ON STOCK

This agreement made this.....day of.....19....,
between.....of....., party of the first part,
and.....of....., party of the second part,
witnesseth:

In consideration of.....dollars, the receipt whereof is
hereby acknowledged, the party of the first part hereby agrees to
sell.....shares of the capital stock of the.....
corporation at dollars per share at any time
within.....days from date.

All dividends or extra dividends declared during said time are
to go with the stock; and days' notice of acceptance
will be given by said party of the second part.

In witness, etc.

Subscription Lists.—The incorporators of a proposed
corporation usually circulate subscription lists to secure
subscribers to such portion of the stock of the proposed
corporation as may be required by law. The subscriptions
may be taken on a single blank or on individual blanks.

FORM 8.

SIMPLE SUBSCRIPTION LIST

The Interstate Chemical Company to be incorporated under
the laws of New Jersey by Rudolph Johnson, B. M. Squires and
Frank A. Ross.

Capital Stock \$100,000

Shares \$100 each.

We, the undersigned, hereby severally subscribe for and agree
to take at their par value the number of shares of the capital
stock of the Interstate Chemical Company set opposite our re-

spective signatures, said subscriptions to become due as soon as said company is organized and to be then payable in cash on demand of the Treasurer of the company.

Newark, New Jersey,
June 1, 1921.

names	addresses	shares	amounts
.....			
.....			
.....			

Subscriptions may be made either revocable or irrevocable and subject to acceptance by the corporation when formed. They are frequently negotiated with a trustee acting for the company as follows:

FORM 9.

TRUSTEE'S SUBSCRIPTION LIST

(Heading same as above.)

We, the undersigned, hereby agree with.....as trustee for the.....company, to subscribe, and do hereby severally subscribe, for the number of shares of the capital stock of said company set opposite our respective signatures, and agree to pay par value thereof as follows:

Ten per cent on demand to.....as Trustee for said company, such payment, or so much thereof as may be necessary, to be used for the preliminary and incorporating expenses of said company; thirty per cent to the Treasurer of the Company so soon as said company is organized; and sixty per cent within ninety days thereafter.

Corporation Charter.—The charter or certificate of incorporation is a contract between the state and the incorporators by virtue of which the corporation is created and its powers are defined. With proper adjustments the form here given would be satisfactory for most small corporations.

FORM 10

CERTIFICATE OF INCORPORATION

OF THE

FIT-WELL CLOTHING CORPORATION

(STATE OF NEW YORK)

We, the undersigned, all being of full age and two-thirds being citizens of the United States and one of us a resident of the state of New York, for the purpose of forming a corporation under the Business Corporation Law of the State of New York, do hereby certify and set forth:

First — The name of said corporation shall be "Fit-Well Clothing Corporation."

Second — The purposes for which said corporation is to be formed are as follows:

(a) To conduct and carry on the business of cutting out, making, and preparing clothing and wearing apparel of all kinds, and of all other articles which may be conveniently or advantageously handled in connection with the aforesaid business.

(b) To buy, sell, import, export, and deal in and with woolen, cotton, silk, and other textile fabrics, and in any and all other materials useful or necessary in the manufacture of clothing or wearing apparel.

(c) To lease, buy, sell, use and hold all such property, real or personal, as may be necessary or convenient in connection with the said business.

(d) To do any and all things set forth in this certificate as objects, purposes, powers or otherwise, to the same extent and as fully as natural persons might do, and in any part of the world.

Third — The amount of capital stock of said corporation shall be Three Hundred Thousand Dollars (\$300,000).

Fourth — The number of shares of which said capital stock is to consist shall be Three Thousand (3,000) shares, of the par value of One Hundred Dollars (\$100) each.

Of said capital stock One Thousand (1,000) shares, of the par value of One Hundred Thousand Dollars (\$100,000) shall be

cumulative preferred stock, entitled to an annual dividend of seven per cent (7%) from the profits of the corporation, payable semi-annually, on the tenth days of January and July in each year, before any dividends are paid upon the common stock, and to share equally with the common stock in any excess paid in any year above seven per cent (7%) to all the stock, and in the event of liquidation or dissolution from any cause said preferred stock shall be entitled to be paid in full from the assets of the corporation before anything is paid to the common stock. The holders of such preferred stock shall not be entitled to vote in any meeting of the stockholders or election of directors, unless the accumulated dividends due and unpaid such preferred stock at the time shall equal or exceed seventeen and one-half per cent (17½%) of the par value of said stock.

Of said capital stock Two Thousand shares of the par value of Two Hundred Thousand Dollars (\$200,000) shall be common stock of the corporation.

Fifth — The principal business office of said corporation shall be located in the Borough of Manhattan and in the City, County and State of New York.

Sixth — The duration of said corporation shall be perpetual.

Seventh — The number of directors of said corporation shall be five.

Eighth — The names and post office addresses of the directors of said corporation for the first year are as follows:

(omitted)

Ninth — The names and post office addresses of the subscribers to this certificate, and the number of shares which each agrees to take in said corporation are as follows:

Names	Addresses	Shares
Julius Goldstein	Broadway, New York City	5
Max Engels	Montclair, New Jersey	5
William J. Friedman	Fifth Ave., New York City	5

Tenth — At all elections of directors of this corporation each stockholder shall be entitled to as many votes as shall equal the number of his shares of stock, multiplied by the number of

directors to be elected, and he may cast all of such votes for a single director or may distribute them among the number to be voted for, or any two or more of them, as he may see fit.

In WITNESS WHEREOF, we have made and signed this certificate in duplicate this 9th day of June, one thousand nine hundred and twenty-one.

JULIUS GOLDSTEIN

MAX ENGELS

WILLIAM J. FRIEDMAN

STATE OF NEW YORK SS:

County of New York

Personally appeared before me this 9th day of June, 1921, Julius Goldstein, Max Engels, and William J. Friedman, to me personally known to be the persons described in and who executed the foregoing certificate and severally acknowledged that they executed the same for the purposes therein set forth.

(notarial)
seal

HENRY J. MILLER,
Notary Public for
New York County

Object or Purpose Clauses.—Attorneys who make a specialty of drafting charters for corporations have prepared a great number of more or less standardized object or purpose clauses applicable to many different kinds of enterprises and businesses. These must be prepared with great care because the corporation possesses only such powers as have been specifically delegated to it, and the courts are usually not very liberal in interpreting these powers. They must, of course, be consistent with the laws of the state in which incorporation is effected.

FORM 11

AUTOMOBILES

To purchase, lease, and acquire lands and buildings for use as manufactories, warehouses, and offices; to manufacture, buy, sell, import, and export vehicles of all kinds propelled by mechanical power; engines and appliances for the generation and use of steam, electricity, gasoline, or other form of power for propelling carriages, wagons, trucks, cars, and vehicles of every kind and description; all parts and portions of such vehicles, engines, and machinery, and all things incident to or used in connection with the same.

FORM 12

DEPARTMENT STORE

To buy, lease, construct, or otherwise acquire storerooms, warehouses, and other buildings; to buy and sell all kinds of merchandise; to equip, conduct, and operate a general department store; to establish therein stores for the purchase and sale of dry goods, millinery, cloth, and fabrics, gents' furnishing goods women's clothing, men's and boy's clothing, hats, boots and shoes, furniture, carpets and draperies, drugs and chemicals, hardware, china and glassware, silver, jewelry, pictures, books, stationery, photographs and photographers' supplies, perfumery, toilet articles, and bicycles. (Enumeration made to cover any classes of business desired).

FORM 13

HARDWARE MANUFACTURE AND SALE

(a) To buy, sell, import, export, and generally deal in and with all kinds of tools, hardware, and machinery; to establish, maintain, and operate shops and factories for the manufacture and construction of all kinds of tools, hardware, machines, and mechanical construction.

(b) To buy, sell, and generally deal in iron, steel, manganese, copper, zinc, brass, and other metals, and in any and all articles made of or partly consisting of metal, wood, and other materials, and to engage in the repair and manufacture of all goods, wares, and commodities dealt in by the corporation.

FORM 14

GROCERY

To do a general grocery business, handling foodstuffs, kitchen, dining-room and nursery utensils and supplies of all kinds; to manufacture, grow, buy, sell, import, export, and deal in canned and preserved foods of all kinds, fruits, vegetables, meats, beverages, and everything known as or used in or sold with groceries; to run eating establishments, cafes, restaurants, and to serve beverages of all kinds therein; to buy, own, sell, deal in vehicles, horses, motors and other conveyances and the accessories thereof for delivering groceries and goods; to do any and all things necessary and useful to forward the foregoing objects.

FORM 15

MINING

(a) To buy, lease, or otherwise acquire mines, mining rights, quarries, and mineral lands of every kind, nature, and description, and to work, mine, prospect, develop, operate, and promote the same; to mine, quarry and excavate copper, gold, silver, and other ores and metals and minerals of all descriptions.

(b) To buy, lease, construct, own, control, operate, and maintain mills, work, and plants for the crushing, sampling, milling, smelting, reduction, and concentration of minerals and metal-bearing ores, and the extraction therefrom of all kinds of metals and mineral products and by-products, on its own account and as factor and agent for others.

(c) To treat, prepare, and manufacture, and to buy, sell, and

generally deal in iron, steel, manganese, coke, copper, lumber, and other materials, and all or any articles consisting of or partly consisting of metal, wood, or other materials, and any and all products and by-products thereof.

FORM 16

INVESTMENT BROKERS

To buy, sell and otherwise acquire, dispose of and deal in government, municipal, corporation, association and individual bonds, mortgages and debentures of all kinds; also in stocks and choses in action of all kinds, in trust receipts, receivers' certificates, commercial paper and securities and evidences of indebtedness of all kinds of social, business and governmental organizations and of individual persons; to do any and all things necessary and useful to forward the purposes herein expressed and implied.

Capital Stock and Special Stock Clauses. — The capital stock clause given in Form 10 may be taken as a standard for par value stock. When stock of no par value is employed the following form is frequently used.

FORM 17

CAPITAL STOCK OF NO PAR VALUE

The number of shares of capital stock that may be issued by said corporation is Three Thousand (3,000) shares which shall have no nominal or par value.

In a few states preferred stock that has no stated or par value may be used. The following form would provide for such stock.

FORM 18

PREFERRED STOCK OF NO PAR VALUE

The holders of the preferred stock of the corporation shall be paid from the surplus profits an annual cumulative dividend of Seven Dollars (\$7) on each and every share of such stock, before any dividend is paid to the holders of the common stock or other disposition is made of such profits, but shall not participate in any further dividends.

The preference as to assets and denial of voting power may be stated as in Form 10.

FORM 19

NON-CUMULATIVE PREFERRED STOCK

Said preferred stock shall entitle the holders to receive in each year a dividend of eight per cent, payable half-yearly, before any dividend shall be set apart or paid on such general or common stock, and if the net profits in any year shall not be sufficient to pay a dividend of eight per cent on said preferred stock, then such dividend shall be paid thereon as the net profits of the year will suffice to pay. The holders of the preferred stock shall have a preference on the assets of the company, but the dividends thereon are not to be cumulative, but shall be payable each year only out of the profits of that year, and such preferred stock and the certificates therefor may be issued by the board of directors by resolution. (American Tobacco Companies).

FORM 20

REPRESENTATIVE TYPES OF PREFERRED STOCK

1. The Sherwin-Williams Company of Canada, Ltd. has an authorized capital stock of \$8,000,000, of which \$4,000,000 consists of seven per cent cumulative preferred stock of \$100 par value, preferred as to assets as well as dividends.

2 The United States Envelope Company, with an authorized capital stock of \$5,000,000, has \$4,000,000 of seven per cent cumulative preferred stock of \$100 par value with preference as to assets as well as dividends and equal voting rights with common stock.

3. The Weyman-Burton Company's preferred stock has preference as to assets as well as to dividends. No prior lien (on the property) to the preferred stock can be created without the consent of two-thirds in interest of each class of stockholders. Both classes have full voting power and are fully paid and non-assessable and no personal liability attaches to the holder.

4. The United Paperboard Company, Inc., has, in addition to \$12,000,000 authorized common stock, \$2,500,000 of six per cent non-cumulative preferred stock of \$100 par value. It has preference as to dividends and assets and is accorded, share for share, the same voting power as the common stock. No mortgage can be created without the consent of three-fourths of the preferred stock outstanding. The preferred stock is also subject to call as a whole for redemption at \$110 per share after three years from date of issue. A sinking fund is also provided for its redemption. (This stock has many of the characteristics of a credit rather than an ownership security).

5. The American Window Glass Company's seven per cent cumulative preferred stock of \$100 par value has preference as to dividends, but not as to assets.

6. The Autosales Corporation's six per cent non-cumulative preferred stock of \$50 par value has preference as to dividends as well as to assets and is participating, so that any dividends declared, after six per cent on preferred and six per cent on common, shall be distributed ratably on preferred and common shares. The consent of seventy-five per cent of the outstanding preferred stock is necessary to mortgage or encumber the property of the corporation. Both classes of stock have equal voting power.

7. The Central Sugar Corporation's seven per cent cumulative preferred stock of \$100 par value has preference to assets as well as dividends and is redeemable at the company's option in whole or in part at \$115 per share and accrued dividends. It is con-

vertible at any time (unless previously called for redemption) at the holder's option into common stock, share for share. No mortgage can be placed on the property without the consent of two-thirds of the outstanding preferred stock. An annual sinking fund of twenty-five per cent of the net profits is to be applied to the retirement of the preferred stock at not exceeding \$115 and accrued dividends. Both classes have equal voting power.

8. The Columbia Graphophone Manufacturing Company has outstanding a seven per cent cumulative non-participating preferred stock of \$100 par value with preference as to dividends and assets. It may be redeemed at \$110 and dividends on any dividend date on two weeks' notice, and when so redeemed it is to be cancelled. The company must set aside, each six months, out of the net profits one and one-half per cent of the maximum par amount of preferred stock theretofore issued, as a sinking fund to be used in the purchase or redemption of preferred stock. This sinking fund requirement is cumulative.

Forms of Stock Certificates.—There are many forms of the stock certificate, but in their essential characteristics they are much alike. The preferred stock certificates practically always give on their face the conditions under which the preferred stock is held and the right and preferences to which the holder is entitled. Where only one class of stock is issued, the common stock certificate is usually very simple, but if several classes of stock are used the preferences of the other classes are frequently set forth on the face of the common stock certificate. On the reverse side of the certificate is printed an assignment and transfer form which is filled in in blank or in the name of the person to whom the shares are sold by the owner. The following forms illustrate some of these points.

FORM 21

NUMBER _____ INCORPORATED UNDER THE LAWS OF THE COMMONWEALTH OF PENNSYLVANIA APRIL 13, 1846		SHARES _____	
The Pennsylvania Railroad Company			
This Certifies that _____ is entitled to _____ Shares in the Capital Stock of The Pennsylvania Railroad Company, transferable only in person or by Attorney on the books of the said Company.		the signatures of the President and Treasurer, at Philadelphia, this _____ day of _____ 19____	
[SEAL]		_____ FOR PRESIDENT	
_____ SECRETARY		_____ FOR TREASURER	
_____ TRANSFER CLERK		_____	
This certificate is transferable either in New York or Philadelphia. This certificate is not valid until countersigned by the Transfer Agent and the Registrar			
SHARES \$50 EACH			

Registered in Philadelphia, _____
 GIRARD TRUST COMPANY.
 REGISTRAR. SECRETARY.

FORM 21 b

[FORM OF ASSIGNMENT ON THE BACK OF THE PENNSYLVANIA RAILROAD
COMPANY STOCK CERTIFICATE]

NOTICE: THE SIGNATURE TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME AS WRITTEN UPON THE FACE
OF THE CERTIFICATE, IN EVERY PARTICULAR, WITHOUT ALTERATION OR ENLARGEMENT, OR ANY CHANGE
WHEREVER.

Know all Men by these Presents,
that_____, the undersigned, for value received, have bargained,
sold, assigned, and transferred, and by these presents do
bargain, sell, assign, and transfer, unto_____

_____ Shares of the Capital Stock of The Pennsylvania
Railroad Company, and do hereby constitute and appoint

_____ true and lawful Attorney; irrevocable, for_____ and in_____ name and stead, but to the use of the above-named assignee to make and execute all necessary acts of assignment and transfer of the said stock on the books of the said Company, and Attorneys one or more to substitute with like full power for the purposes aforesaid, hereby ratifying and confirming all that said Attorney, or his substitute or substitutes shall lawfully do by virtue hereof.

In Witness Whereof,_____ have hereunto set
_____ hand and seal, this_____ day
of_____ one thousand nine hundred
and_____

Signed, Sealed, and Delivered
in presence of

FORM 22

SEVEN PER CENT CUMULATIVE PREFERRED STOCK

NUMBER

SHARES



INCORPORATED UNDER THE LAWS OF THE STATE OF NEW JERSEY

United States Steel Corporation

This is to Certify that

is the owner of _____ shares of the par value of one hundred dollars each, in the PREFERRED CAPITAL STOCK of United States Steel Corporation, transferable only in person or by attorney upon the books of said Corporation, upon surrender of this certificate. The holders of the preferred stock shall be entitled to receive, when and as declared, from the surplus or net profits of the Corporation, yearly dividends at the rate of seven per centum per annum, and no more, payable quarterly on dates to be fixed by the by-laws. The dividends on the preferred stock shall be cumulative, and shall be payable before any dividend on the common stock shall be paid or set apart; so that, if, in any year dividends amounting to seven per cent shall not have been paid thereon, the deficiency shall be payable before any dividends shall be paid upon or set apart for the common stock. Whenever all cumulative dividends on the preferred stock for all previous years shall have been declared, and the company shall have paid such cumulative dividends quarterly installments for the current year shall have been declared, and the company shall have paid such cumulative dividends for previous years and such accrued quarterly installments, or shall have set aside from its surplus or net profits a sum sufficient for the payment thereof, the Board of Directors may declare dividends on the common stock, payable then or thereafter, out of any remaining surplus or net profits. In the event of any liquidation or dissolution or winding up (whether voluntary or involuntary) of the Corporation, the holders of the preferred stock shall be entitled to be paid in full both the par amount of their shares and the unpaid dividends accrued thereon, before any amount shall be paid to the holders of the common stock; and after the payment to the holders of the preferred stock of its par value, and the unpaid accrued dividends thereon, the remaining assets and funds shall be divided and paid to the holders of the common stock according to their respective shares. The preferred stock and the common stock may be increased as provided in the Certificate of Incorporation. This certificate is not valid without the signatures of the Transfer Agent and Registrar of Transfer. WITNESS the signatures of the President, or of a Vice-President, and of the Treasurer or of an Assistant Treasurer, of said Corporation.

by

HUDSON TRUST COMPANY,
TRANSFER AGENT.

ASST. SECRETARY.

ASST. TREASURER

SHARES \$100 EACH

VICE PRESIDENT

REGISTERED,
NEW YORK SECURITY AND TRUST COMPANY,

by

FORM 22 b

[FORM OF ASSIGNMENT ON THE BACK OF THE UNITED STATES STEEL CORPORATION
PREFERRED STOCK CERTIFICATE]

For value Received _____ *hereby sell, assign, and transfer unto*

_____ *Shares*
of the Capital Stock represented by the within Certificate
and do hereby irrevocably constitute and appoint

_____ *Attorney*
to transfer the said stock on the Books of the within named
Corporation with full power of substitution in the premises.

Dated _____ *19* _____

In Presence of

NOTICE: THE SIGNATURE TO THIS ASSIGNMENT MUST CORRESPOND WITH THE NAME AS WRITTEN UPON THE FACE OF THE CERTIFICATE, IN EVERY PARTICULAR, WITHOUT ALTERATION OR ENLARGEMENT, OR ANY CLAUSE WHATSOEVER.

FORM 23

CERTIFICATE OF COMMON STOCK GIVING TERMS OF

Number	PREFERRED ISSUE	Shares
2506		.....

URBAN MOTION PICTURE INDUSTRIES, INC.

Incorporated Under the Laws of the State of New York.

Capital Stock, \$10,500,000

Preferred, \$3,500,000 — Common, \$7,000,000

Not Valid Unless Countersigned by the Empire Trust Co.

THIS CERTIFIES THAT.....is the owner of
Shares of the COMMON CAPITAL
 STOCK OF THE URBAN MOTION PICTURE INDUSTRIES, INC., full
 paid and non-assessable, transferable only on the books of this
 Corporation in person or by Attorney upon surrender
 of this certificate properly endorsed.

The Preferred Stock shall be entitled to receive
 cumulative dividends at the rate of eight per cent
 per annum, payable semi-annually, and no more, out
 of the earnings of the Corporation, in preference to
 any dividends upon the Common Stock, and such
 stock shall be entitled to be paid in full upon any
 distribution of the assets of the Corporation before any
 distribution of capital shall be made to Common
 Stock, but shall not be entitled to vote at any meeting
 (SEAL) of the stockholders except as expressly required by
 statute.

IN WITNESS WHEREOF, the said Corporation has
 caused this Certificate to be signed by its duly
 authorized officers and its Corporate Seal to be here-
 unto affixed, this.....day of.....A.D.
 192..

.....
Asst. Secretary or Treasurer.

.....
President or Vice-President.

SHARES \$25 EACH

Empire Trust Company, Transfer Agent

Countersigned

By.....
Asst. Sec'y.

FORM 24

CERTIFICATE OF COMMON STOCK WITHOUT PAR OR
NOMINAL VALUE

NEW YORK

Full Paid and Non-assessable.

No.....Shares

United Motors Corporation.

Incorporated under the laws of the State of New York.

Total authorized stock, 1,200,000 shares, all without nominal or
par value.

"Class A," 1,195,000 shares.

"Class B," 5,000 shares.

This certifies that.....is the owner
of.....shares of the "Class A" stock, full paid and non-
assessable, without nominal or par value, of United Motors Cor-
poration, transferable in person or by attorney, on the books
of the corporation, on surrender of this certificate duly indorsed.

The authorized stock of said corporation consists of 1,195,000
shares of "Class A" and 5,000 shares of "Class B" stock, all
without nominal or par value. Only the holders of the "Class B"
stock are entitled to voting power of said corporation, but the
holders of "Class A" stock are entitled to all other rights and
privileges of stockholders in said corporation. This certificate
is not valid until countersigned by the transfer agent and
registered by the registrar.

Witness the seal of the corporation and the signature of its
duly authorized officers this.....day of.....19...

.....

.....

Asst. Secretary.

Vice-President.

Registered:

Bankers Trust Company, Registrar,

By.....Asst. Secretary.

Countersigned:

Guaranty Trust Co. of New York,

By.....Asst. Secretary.

Lost Certificates. — In case a certificate becomes lost the transfer agent is notified to stop the transfer of the title to the stock, and a notice such as the following is usually inserted in the financial columns of the daily papers.

FORM 25

NOTICE OF STOPPAGE OF TRANSFER

Lost — Certificate No. B. 110042 for 10 shares Northern Pacific Railway Co.; certificate No. N-25355 for 10 shares Chesapeake & Ohio Railroad; certificate No. A-70519 for 10 shares New York Central Railroad; all in the name of.....lost in transit between City Hall Post Office, New York, and the First National Bank, Bradentown, Florida. Transfer has been stopped. If found kindly notify Atlantic National Bank, 237 Broadway, New York.

In order to have a new certificate issued to replace one that has been lost or destroyed a bond of indemnity similar to the following is required of the owner.

FORM 26

BOND OF INDEMNITY FOR REISSUE OF LOST STOCK
CERTIFICATE

The undersigned, George Burton and the Fidelity Surety Company, hereby acknowledge ourselves as held and firmly bound unto the Motive Power Company of New York in the sum of ten thousand dollars (\$10,000), for the payment of which to the said corporation, its successors and assigns, we jointly and severally bind ourselves, our heirs, executors, administrators and successors.

Signed and sealed by us this day of 19...
The condition of the above obligation is as follows:

Whereas, The said George Burton is recorded on the transfer books of said Motive Power Company of New York as the owner of fifty (50) shares of the capital stock of said company, and

Whereas, His original certificate of stock No. 3, issued by said company, evidencing his ownership of fifty shares of stock has been lost, stolen or destroyed, as he has complained to said company, and

Whereas, Upon application of the said George Burton and pursuant to a resolution of the board of directors of the said Motive Power Company of New York granting the same, a new certificate for the said fifty shares has been this day issued to said George Burton and numbered 57;

Now, Therefore, If the said George Burton, his heirs, executors and administrators shall now, and at all times hereafter, save, defend, keep harmless and indemnify the said Motive Power Company of New York, its legal representatives, successors and assigns from, against and on account of all demands, claims or causes of action arising out of, upon, or connected with said certificate No. 3, for said fifty shares of stock in said company, or any actual or pretended purchase or assignment thereof, and from all costs, expenses and damages that shall or may arise therefrom, and shall also surrender and deliver up to said company for cancellation the said certificate No. 3 whenever and so soon as it may be found, then the obligation shall be void. Otherwise in full force and effect.

GEORGE BURTON,
The Fidelity Surety Company.

By M. A. Allen, General Agent.

Signed, sealed and delivered in presence of Arthur B. Morgan, Joseph Harper.

Bond Forms.—While bonds are not essential to the organization of a corporation, they are, nevertheless, extensively employed to procure capital and hence, are important elements of capitalization. The following very simple forms have been selected to illustrate some of the features of the bond touched upon in the text.

FORM 27

MORTGAGE TO SECURE BONDS, SHORT FORM

This mortgage made the day of, A.D. 19...., by the.....Company, of the city of Indianapolis, county of Marion, state of Indiana, party of the first part, hereinafter called the mortgagor, unto The Trust Company of the city of Indianapolis, county of Marion, state of Indiana, trustee for those holding the obligation secured by this instrument, party of the second part hereinafter called the mortgagee.

Witnesseth, that said mortgagor in consideration of the sum of.....dollars, the receipt of which is hereby acknowledged, and for the purpose of securing the repayment of said sums with interest, as hereinafter provided, and the performance of the covenants hereinafter contained, hereby mortgages and warrants unto the said mortgagee, assigns or successors, in this trust, and their successors, the lands, premises and property situated in the city of Indianapolis, county of Marion and state of Indiana, described as follows: (here Describe), together with all and singular the hereditaments and appurtenances belonging to said mortgagor, and situated on the above described premises, and all that may hereafter be put thereon or attached thereto in any way or form, together with the franchises belonging to said mortgagor.

Provided always, and these presents are upon the express condition that whereas, the said.....Company, mortgagor, has executed bonds of the denomination of \$1,000 each with coupons for the semi-annual interest thereon at the rate of.....per cent per annum, bearing even date herewith, and delivered the same to the mortgagee, the principal sum of which said bonds is payable on the.....day of....., A.D. 19.., and the interest thereon is payable on the days of.....and.....in each and every year hereafter until the said principal sum shall be paid according to the tenor and effect of said bonds and coupon interest notes, and which said principal and interest is payable at....., if said mortgagor

shall pay or cause to be paid said bonds and the interest thereon as above provided, and shall keep and perform the covenants and agreements herein contained by.....to be performed, then these presents and said bonds shall cease and shall be null and void. And the said.....Company, mortgagor for itself, successors and assigns, hereby covenants with said mortgagee, its legal representatives and assigns, as follows:

First. Said mortgagor will pay to said mortgagee, its legal representative and assigns, the said sum of.....dollars with interest thereon, at the rate of.....per cent per annum, payable.....annually, until the full payment of said principal sum according to the terms of said bonds aforementioned, and will pay interest at the rate of.....per cent per annum, semi-annually, upon all overdue interest or principal from the time of its maturity.

Second. The said mortgagor within forty days after same shall become due and payable will pay all taxes and assessments, rates and charges, and all labor, mechanics' or other liens of every name and nature which shall be levied or imposed upon said property, or upon or on account of this mortgage or the indebtedness secured hereby or upon the interest or estate in said property represented by this mortgage, whether levied or imposed against the said mortgagor or mortgagee, and the mortgagor hereby waives any and all claim or right against said mortgagee its legal representatives or assigns or..... successors in this trust, to any payments or rebate on or offset against the interest or principal of said indebtedness by reason of the payment of any of said taxes, assessments, rates, charges or labor or mechanics' liens. Provided, however, that if the sum of interest due under this mortgage in any one year, plus the taxes levied upon or on account of said mortgage in the same year shall exceed the rate of interest allowed by law to be stipulated therefor, that such excess of taxes shall be paid by said trustee and the party of the first part shall in no case be liable therefor.

Third. That the said mortgagor will keep all destructible property described in this mortgage or situated upon the lands described in this mortgage insured against loss and damage by fire in responsible insurance companies approved by the

mortgagee, to an amount not less than.....dollars, and pay the premiums therefor. All loss in policies for said insurance to be payable to said mortgagee, as.....interest, created by this mortgage may appear, and will deliver the said policies, as soon as issued to said mortgagee.

Fourth. If said mortgagor makes default in the payment of any of the aforesaid taxes, assessments, rates and charges of labor, mechanics' or other liens and effect such insurance and the sum so paid shall be further lien on the aforesaid premises and property under this mortgage, prior and superior to said bonds and coupons and payable forthwith, with interest at the rate of.....per cent per annum.

Fifth. Should default be made in the payment of any instalment of principal maturing hereon before the whole thereof becomes due or of any instalment of interest when the same becomes due and payable or of any taxes, assessments, rates and charges or of any labor mechanics' or other liens or of any premiums for insurance, or any part thereof, when the same are payable as above provided, and should the same or any part thereof remain unpaid for a period of thirty days, then and from thenceforth, the aforesaid principal sum with all arrearages of interest, shall at the option of said mortgagee, its legal representatives or assigns, become due and payable therefrom and thereafter, although the period above limited for the payment of the same shall not then have expired, anything hereinbefore or in said bonds contained to the contrary thereof in anywise notwithstanding.

Sixth. All the aforesaid covenants shall run with the land.

Seventh. That upon default being made in the payment of principal or interest thereon, or of any part thereof at the time the same becomes due and payable according to the terms hereof, the same mortgagee, its legal representative or assigns, are hereby authorized and empowered to foreclose this mortgage in any court of competent jurisdiction, and any judgment rendered in such suit in favor of the plaintiff therein shall include a reasonable fee for the attorney of the plaintiff for his services in such suit.

IN WITNESS WHEREOF the said mortgagor has hereunto set its hand and seal the day and year first above written.

The.....Company

By.....,

President.

(SEAL)

Attest:.....

Secretary.

STATE OF INDIANA, COUNTY OF MARION, SS:

Personally appeared before me,.....a notary public in and for said county and state, the above named The.....Company, by its president,....., and acknowledged the execution of the above and foregoing mortgage.

Witness my hand and notarial seal this.....day of....., A.D. 19.....

(SEAL)

.....,

Notary Public.

FORM 28

A SIMPLE FORM OF BOND CERTIFICATE

No. _____

UNITED STATES OF AMERICA. STATE OF OHIO

\$1,000.

THE COLUMBUS CONSOLIDATED STREET RAILROAD COMPANY

First Mortgage Twenty Year Five Per Cent. Gold Bond

FOR VALUE RECEIVED, THE COLUMBUS CONSOLIDATED STREET RAILROAD COMPANY, a corporation organized and existing under the Laws of the State of Ohio and operating street railroads in the City of Columbus, promises to pay to the Central Trust Company of New York, Trustee, or to the bearer or registered owner hereof, ONE THOUSAND DOLLARS, in gold coin of the United States of America, of the present standard, on the first day of July, 1909, and to pay interest thereon at the rate of five per cent per annum from the first day of July, 1899, on the first days of January and July in each year, on the presentation and surrender of the coupons hereto annexed as they severally become due, until said principal sum shall be paid, both principal and interest of this bond being payable at the agency of said Railroad Company in the City of New York. This bond is subject to redemption on or after July 1, 1894, at 110 per cent of the par value thereof, with accrued interest, out of a sinking fund of \$22,500 a year, beginning with that date, as provided in the mortgage herein described. This bond is one of a series of Eight Hundred bonds, of like tenor, date, and amount, numbered consecutively from One to Eight Hundred, both inclusive, and amounting in the aggregate to Eight Hundred Thousand Dollars, which are all equally secured by a mortgage of said Railroad Company in the nature of a conveyance in trust, dated July 1, 1889, and duly recorded, conveying all the property and franchises of said Railroad Company to said Trust Company, in trust, for the benefit of the holders of said bonds, to all the provisions of which mortgage this bond is subject. In case of default for six months after due demand in payment of any interest on any of said bonds, the principal of all thereof may be declared due, as provided in said mortgage. The principal of this bond may be registered on the books of said Railroad Company at its said agency, and registration thereof noted hereon, after which no transfer thereof shall be valid, except on said books, until after registered transfer to bearer, when the principal of the bond will again become transferable by delivery. The coupons annexed to this bond will always be transferable by delivery. This bond shall not be valid unless authenticated by the Certificate of the trustee of said mortgage.

IN WITNESS WHEREOF, said Railroad Company has caused its corporate seal to be affixed, and this bond to be subscribed by its President and Secretary, and the name of its Treasurer to be engraved on the several coupons hereto annexed, at the City of Columbus, in the State of Ohio, this first day of July in the year Eighteen Hundred and Eighty-nine.

.....Secretary

(Note — See also reverse side.)

.....President

FORM 28a

[Tile, on back]

No. The Columbus Consolidated Street Railroad Company First Mortgage \$1000 Twenty Year Five per cent. Gold Bond. Due July 1, 1909. Interest payable January 1 and July 1. Principal and Interest payable at agency of the Company in the City of New York.

[On the back]

TRUSTEES' CERTIFICATE. — The Central Trust Company of New York, Trustee, hereby certifies that this bond is one of the series of Eight Hundred mortgage bonds described in the mortgage mentioned herein, bearing date the first day of July, 1889.

CENTRAL TRUST COMPANY OF NEW YORK, Trustee

By..... *Vice-President*

NOTICE! — No writing on this Bond, except by an officer of the Company.

DATE OF REGISTRY	IN WHOSE NAME REGISTERED	TRANSFER AGENT

[On the end, forty Coupons, numbered on the back, and dated each first day of January and July, from 1890 to 1909, the face of the first one reading:]

\$25. Coupon No. 1. — On the first day of January, 1890, The Columbus Consolidated Street Railroad Company will pay the bearer, at its agency in the City of New York, Twenty-five Dollars, being the semi-annual interest then due on its First Mortgage Bond No.

E. K. STENORFF, *Treasurer*

By-Laws. — The corporate by-laws are the basic rules that are laid down by the stockholders to govern the management of the administrative affairs of the corporation. In small corporations, where practically all of the stockholders are also the directors, by-laws are usually reduced to a minimum or are dispensed with entirely. However, in large corporations they are extremely important because they serve as a grant of authority to the directors and officers and also, in a measure, set forth their duties and obligations. With the exception of special features and arrangements, by-laws have become more or less standardized, at least in so far as the general topics treated are concerned. In this respect the by-laws of the United States Steel Corporation may be looked upon as a standard.

FORM 29

BY-LAWS OF UNITED STATES STEEL CORPORATION
AS ON SEPTEMBER 24, 1918¹

ARTICLE I

STOCKHOLDERS

SECTION 1. *Annual Meeting.* The annual meeting of the stockholders of the Company shall be held annually at the principal office of the Company in the State of New Jersey, at twelve o'clock noon, on the third Monday in April in each year, if not a legal holiday, and if a legal holiday then on the next succeeding Monday not a legal holiday, for the purpose of electing directors, and for the transaction of such other business as may be brought before the meeting; and the terms of office of the directors of the several classes shall continue until the election of their successors at such meeting as provided in Article II. hereof.

Stockholders' Annual Meeting.

Date of Meeting.

¹ By courtesy of the United States Steel Corporation.

It shall be the duty of the Secretary to cause notice of each annual meeting to be published once in each of the four calendar weeks next preceding the meeting in at least one newspaper in each of the following places: Jersey City, N. J., New York, N. Y., Chicago, Ill., and Pittsburgh, Pa. Nevertheless, a failure to publish such notice, or any irregularity in such notice, or in the publication thereof, shall not affect the validity of any annual meeting, or of any proceedings at any such meeting.

Advertising Notice of Meeting. SECTION 2. *Special Meetings.* Special meetings of the stockholders may be held at the principal office of the Company in the State of New Jersey, whenever called in writing, or by vote by a majority of the Board of Directors.

Advertising Notice of Meetings. Notice of each special meeting, indicating briefly the object or objects thereof, shall by the Secretary be published once in each of the four calendar weeks next preceding the meeting, in at least one newspaper in each of the following places: Jersey City, N. J., New York, N. Y., Chicago, Ill., and Pittsburgh, Pa. Nevertheless if all the stockholders shall waive notice of a special meeting, no notice of such meeting shall be required; and whenever all the stockholders shall meet in person or by proxy, such meeting shall be valid for all purposes without call or notice, and at such meeting any corporate action may be taken.

Quorum. SECTION 3. *Quorum.* At any meeting of the stockholders the holders of one-third of all of the shares of the capital stock of the Company, present in person or represented by proxy, shall constitute a quorum of the stockholders for all purposes, unless the representation of a larger number shall be required by law, and, in that case, the representation of the number so required, shall constitute a quorum.

If the holders of the amount of stock necessary to constitute a quorum shall fail to attend in person or by proxy at the time and place fixed by these by-laws for an annual meeting, or fixed by notice as above provided for a special meeting called by the directors, a majority in interest of the stockholders present in person or by proxy may adjourn, from time to time, without notice other than by announcement at the meeting, until holders

of the amount of stock requisite to constitute a quorum shall attend. At any such adjourned meeting at which a quorum shall be present, any business may be transacted which might have been transacted at the meeting as originally notified.

SECTION 4. Organization. The Chairman of the Board and in his absence, the Chairman of the Finance Committee, and in the absence of both, the President, shall call meetings of the stockholders to order, and shall act as chairman of such meetings. The Board of Directors or Finance Committee may appoint any stockholder to act as chairman of any meeting in the absence of the Chairman of the Board and of the Chairman of the Finance Committee and of the President.

The Secretary of the Company shall act as secretary at all meetings of the stockholders: but in the absence of the secretary at any meeting of the stockholders the presiding officer may appoint any person to act as secretary of the meeting.

SECTION 5. Voting. At each meeting of the stockholders, every stockholder shall be entitled to vote in person, or by proxy appointed by instrument in writing, subscribed by such stockholder or by his duly authorized attorney, and delivered to the inspectors at the meeting; and he shall have one vote for each share of stock standing registered in his name at the time of the closing of the transfer books for said meeting. The votes for directors, and, upon demand of any stockholder, the votes upon any question before the meeting, shall be by ballot.

At each meeting of the stockholders, a full, true and complete list, in alphabetical order, of all of the stockholders, entitled to vote at such meeting, and indicating the number of shares held by each, certified by the Secretary or by the Treasurer, shall be furnished. Only the persons in whose names shares of stock stand on the books of the Company at the time of the closing of the transfer books for such meeting, as evidenced by the list of stockholders so furnished, shall be entitled to vote in person or by proxy on the shares so standing in their names.

Prior to any meeting, but subsequent to the time of closing the transfer books for such meeting, any proxy may submit his

powers of attorney to the Secretary, or to the Treasurer, for examination. The certificate of the Secretary, or of the Treasurer, as to the regularity of such powers of attorney, and as to the number of shares held by the persons who severally and respectively executed such powers of attorney, shall be received as *prima facie* evidence of the number of shares represented by the holder of such powers of attorney for the purpose of establishing the presence of a quorum at such meeting and of organizing the same, and for all other purposes.

SECTION 6. *Inspectors.* At each meeting of the stockholders, the polls shall be opened and closed, the proxies and ballots shall be received and be taken in charge, and all questions touching the qualification of voters and the validity of proxies and the acceptance or rejection of votes, shall be decided by three inspectors. Such inspectors shall be appointed by the Board of Directors before or at the meeting, or, if no such appointment shall have been made, then by the presiding officer at the meeting. If for any reason any of the inspectors previously appointed shall fail to attend or refuse or be unable to serve, inspectors in place of any so failing to attend or refusing or unable to attend, shall be appointed in like manner.

ARTICLE II

BOARD OF DIRECTORS

SECTION 1. *Number, Classification and Term of Office.*
Directors. The business and the property of the Company shall be managed and controlled by the Board of Directors.

As provided in the certificate of incorporation, the directors shall be classified in respect of the time for which they shall severally hold office, by dividing them into three classes, each class consisting of one-third of the whole number of the Board of Directors. The directors of the first class shall be elected for a term of one year; the directors of the second class shall be elected for a term of two years, and the directors of the third class shall be elected for

a term of three years. At each annual election, the successors to the directors of the class whose term shall expire in that year, shall be elected to hold office for the term of three years, so that the term of office of one class of directors shall expire in each year.

Terms of each Class.

The number of directors shall be fifteen; but the number of directors may be altered from time to time by the alteration of these by-laws.

Number of Directors.

In case of any increase of the number of directors, the additional directors shall be elected by the directors then in office; one-third of such additional directors for the unexpired portion of the term of one year; one-third for the unexpired portion of the term of two years, and one-third for the unexpired portion of the term of three years, so that each class of directors shall be increased equally.

Every director shall be a holder of at least one share of the capital stock of the Company. Each director shall serve for the term for which he shall have been elected, and until his successor shall have been duly chosen.

Directors must be Stock-holders.

At all elections of the directors, the polls shall remain open for at least one hour, unless every registered owner of shares has sooner voted in person or by proxy, or in writing has waived the statutory provision.

Polls open one hour.

SECTION 2. Vacancies. In case of any vacancy in the directors of any class through death, resignation, disqualification or other cause, the remaining directors, by affirmative vote of the majority thereof, may elect a successor to hold office for the unexpired portion of the term of the director whose place shall be vacant, and until the election of his successor. Such vacancy shall be filled upon and after nominations therefor shall have been made by the Finance Committee.

Vacancies in Board.

SECTION 3. Place of Meeting, etc. The directors may hold their meetings, and may have an office and keep the books of the Company (except as otherwise may be provided for by law) in such place or places in the State of New Jersey or outside of the State of New Jersey, as the Board from time to time may determine.

Place of Meeting.

SECTION 4. *Regular Meetings.* Regular meetings of the Board of Directors shall be held monthly on the last Tuesday of each month, if not a legal holiday, and if a legal holiday, then on the next succeeding Tuesday not a legal holiday. No notice shall be required for any such regular monthly meeting of the Board.

SECTION 5. *Special Meetings.* Special Meetings of the Board of Directors shall be held whenever called by direction of the Chairman of the Board, or the Chairman of the Finance Committee, or the President, or of one-third of the directors for the time being in office.

The Secretary shall give notice of each special meeting by mailing the same at least two days before the meeting, or by telegraphing the same at least one day before the meeting, to each director; but such notice may be waived by any director. Unless otherwise indicated in the notice thereof, any and all business may be transacted at a special meeting. At any meeting at which a director shall be present, even though without notice, any business may be transacted.

SECTION 6. *Quorum.* Seven Directors shall constitute a quorum for the transaction of business; but if at any meeting of the Board there be less than a quorum present, a majority of those present may adjourn the meeting from time to time.

The affirmative vote of at least one-third of all the Directors for the time being in office shall be necessary for the passage of any resolution.

SECTION 7. *Order of Business.* At meetings of the Board of Directors business shall be transacted in such order as, from time to time, the Board may determine by resolution.

At all meetings of the Board of Directors, the Chairman of the Board, or in his absence the Chairman of the Finance Committee, or, in the absence of both of these officers, the President shall preside.

SECTION 8. *Contracts.* Inasmuch as the Directors of this Company are men of large and diversified business interests, and are likely to be connected with other corporations with which from time to time this Company must

have business dealings, no contract or other transaction between this Company and any other corporation shall be affected by the fact that directors of this Company are interested in, or are directors or officers of, such other corporation, if, at the meeting of the Board, or of the committee of this Company, making, authorizing or confirming such contract or transaction, there shall be present a quorum of directors not so interested; and any director individually may be a party to, or may be interested in, any contract or transaction of this company, provided that such contract or transaction shall be approved or be ratified by the affirmative vote of at least seven directors not so interested.

**Requiring
vote of at
least seven
disinterested
Directors.**

The Board of Directors in its discretion may submit any contract or act for approval or ratification at any annual meeting of the stockholders, or at any meeting of the stockholders called for the purpose of considering any such act or contract; and any contract or act that shall be approved or be ratified by the vote of the holders of a majority of the capital stock of the Company which is represented in person or by proxy at such meeting (provided that a lawful quorum of stockholders be there represented in person or by proxy) shall be valid and as binding upon the corporation and upon all the stockholders as though it had been approved or ratified by every stockholder of the corporation.

**Ratification
by Stock-
holders of
Acts or
Contracts.**

SECTION 9. *Compensation of Directors.* For his attendance at any meeting of the Board of Directors, or Finance Committee, every director shall receive an allowance of One hundred dollars for attendance at each meeting.

**Compensa-
tion of
Directors.**

SECTION 10. *Election of Officers and Committees.* At the first regular meeting of the Board of Directors in each year (at which a quorum shall be present) held next after the annual meeting, the Board of Directors shall proceed to the election of the executive officers of the Company, and of the Finance Committee to be elected by the Board of Directors under the provisions of Article III. and Article IV. of the By-Laws.

**Election of
Officers and
Committees.**

ARTICLE III

FINANCE COMMITTEE

SECTION 1. The Board of Directors shall elect from the Directors a *Finance Committee*, and shall designate for such committee a chairman, who shall continue to be chairman of the committee during the pleasure of the Board of Directors.

The Board of Directors shall fill vacancies in the Finance Committee by election from the directors; and at all times it shall be the duty of the Board of Directors to keep the membership of such committee full, with due regard to the qualifications for such membership indicated in this Article of the By-Laws.

All action by the Finance Committee shall be reported to the Board of Directors at its meeting next succeeding such action, and shall be subject to revision or alteration by the Board of Directors; *provided*, that no rights or acts of third parties shall be affected by any such revision or alteration.

The Finance Committee shall fix its own rules of proceeding, and shall meet where and as provided by such rules, or by resolution of the Board of Directors, but in every case the presence of at least four members shall be necessary to constitute a quorum.

In every case the affirmative vote of a majority of all of the members of the committee present at the meeting, shall be necessary to its adoption of any resolution.

SECTION 2. *The Finance Committee* shall consist of six members, besides the Chairman of the Board, who, by virtue of his office, shall be a member of the Finance Committee. So far as practicable each of the six elected members of the Finance Committee shall be a person of experience in matters of finance. Unless otherwise ordered by the Board of Directors, each elected member of the Finance Committee shall continue to be a member thereof until the expiration of his term of office as a director.

The Finance Committee shall have special charge and control of all financial affairs of the Company. The President, the Vice-Presidents, the General Counsel, the Treasurer, the Comptroller and the Secretary, and their respective offices shall be under the direct control and supervision of the Finance Committee, and of its Chairman when the Committee is not in session.

During the intervals between the meetings of the Board of Directors, the Finance Committee shall possess, and may exercise all the powers of the Board of Directors, in the management of all the affairs of the Company, including its purchases of property, and the execution of legal instruments with or without the corporate seal in such manner as said committee shall deem to be best for the interests of the Company, in all cases in which the specific directions shall not have been given by the Board of Directors.

During the intervals between the meetings of the Finance Committee, and subject to its review, the Chairman of the Board and the Chairman of the Finance Committee together, shall possess, and may exercise any of the powers of the committee, except as from time to time provided by resolution of the Board of Directors.

Except as otherwise provided by the By-Laws, or by resolution of the Board of Directors, all salaries and compensations paid or payable by the Company shall be fixed by the Finance Committee.

No director not an executive officer shall become a salaried employee of the Company except by special vote of the Finance Committee.

ARTICLE IV

OFFICERS

SECTION 1. Officers. The executive officers of the Company shall be a Chairman of the Board of Directors, a Chairman of the Finance Committee, a President, a General Counsel, a Treasurer, a Secretary and a Comptroller all of whom shall be elected by the Board of Directors.

The Board of Directors may appoint such other officers as they may deem necessary, who shall have such authority and shall perform such duties as from time to time may be prescribed by the Board of Directors.

One person may hold more than one office.

In its discretion, the Board of Directors by the vote of a majority thereof may leave unfilled for any such period as it may fix by resolution, any office except those of President, Treasurer, Secretary and Comptroller.

All officers and agents shall be subject to removal at any time by the affirmative vote of a majority of the whole Board of Directors. All officers, agents and employees, other than officers appointed by the Board of Directors, shall hold office at the discretion of the committee or of the officer appointing them.

Each of the salaried officers of the corporation shall devote his entire time, skill and energy to the business of the corporation, unless the contrary is expressly consented to by the Board of Directors or the Finance Committee. No vacation shall be taken by any such officers except by consent of the Board of Directors or the Finance Committee.

The Finance Committee shall have power to remove all officers, agents and employees of the Company, except officers elected or appointed by the Board of Directors.

SECTION 2. Powers and Duties of the Chairman of the Board. The Chairman of the Board of Directors shall be the chief executive officer of the corporation and, subject to the Board of Directors and Finance Committee, shall be in general charge of the affairs of the corporation. He shall preside at all meetings of the stockholders and of the Board of Directors; and by virtue of his office shall be a member of the Finance Committee.

SECTION 3. Powers and Duties of the President. In the absence of the Chairman of the Board and the Chairman of the Finance Committee, the President shall preside at all meetings of the stockholders and of the Board of Directors. Subject to the Board of Directors and the Finance Committee, he shall have general charge of the

business of the corporation relating to manufacturing, mining and transportation and general operation. He shall keep the Board of Directors and the Finance Committee and the Chairman of the Board and the Chairman of the Finance Committee fully informed, and shall freely consult them concerning the business of the corporation in his charge. He may sign and execute all authorized bonds, contracts, checks or other obligations in the name of the corporation, and with the treasurer or an assistant treasurer may sign all certificates of the shares in the capital stock of the corporation. He shall do and perform such other duties as from time to time may be assigned to him by the Board of Directors.

Vice-Presidents. SECTION 4. *Vice-Presidents.* The Board of Directors may appoint a vice-president or more than one vice-president. Each vice-president shall have such powers, and shall perform such duties, as may be assigned to him by the Board of Directors or the Finance Committee.

General Counsel. SECTION 5. *The General Counsel.* The General Counsel shall be the chief consulting officer of the Company in all legal matters, and subject to the Board of Directors and the Finance Committee, shall have general control of all matters of legal import concerning the Company.

Treasurer. Powers and Duties. SECTION 6. *Powers and Duties of Treasurer.* The Treasurer shall have the custody of all the funds and securities of the Company which may have come into his hands; when necessary or proper he shall endorse on behalf of the Company, for collection, checks, notes and other obligations, and shall deposit the same to the credit of the Company in such bank or banks or depository as the Board of Directors or the Finance Committee may designate; he shall sign all receipts and vouchers for payments made to the Company; jointly with such other officer as may be designated by the Finance Committee, he shall sign all checks made by the Company, and shall pay out and dispose of the same under the direction of the Board or of the Finance Committee; he shall sign with the President, or such other person or persons as may be designated for the purpose by the Board of Directors or the Finance Committee, all bills of exchange and promissory notes of the Company; he may sign, with the President or a Vice-

President, all certificates of shares in the capital stock; whenever required by the Board of Directors or by the Finance Committee, he shall render a statement of his cash account; he shall enter regularly, in books of the Company to be kept by him for the purpose, full and accurate account of all moneys received and paid by him on account of the Company; he shall, at all reasonable times, exhibit his books and accounts to any director of the Company upon application at the office of the Company during business hours; and he shall perform all acts incident to the position of treasurer, subject to the control of the Board of Directors or of the Finance Committee.

He shall give a bond for the faithful discharge of his duties in such sum as the Board of Directors or the Finance Committee may require.

SECTION 7. *Assistant Treasurers.* The Board of Directors or the Finance Committee may appoint an assistant treasurer or more than one assistant treasurer. Each assistant treasurer shall have such powers and shall perform such duties as may be assigned to him by the Board of Directors, or by the Finance Committee.

Assistant Treasurers. **SECTION 8. *Powers and Duties of Secretary.*** The Secretary shall keep the minutes of all meetings of the Board of Directors, and the minutes of all meetings of the stockholders, and also (unless otherwise directed by the Finance Committee) the minutes of all committees, in books provided for that purpose; he shall attend to the giving and serving of all notices of the Company; he may sign with the president in the name of the Company all contracts authorized by the Board of Directors or by the Finance Committee, and, when so ordered by the Board of Directors or the Finance Committee, he shall affix the seal of the Company thereto; he shall have charge of the certificate books, transfer books and stock ledgers, and such other books and papers as the Board of Directors or the Finance Committee may direct, all of which shall, at all reasonable times, be open to the examination of any director, upon application at the office of the Company during business hours; and he shall in general perform all the duties incident to the office of secretary, subject to the control of the Board of Directors and of the Finance Committee. The offices of Secre-

tary and of Treasurer may be held by one and the same person.

SECTION 9. Assistant Secretaries. The Board of Directors or the Finance Committee may appoint one assistant secretary or more than one assistant secretary. Each assistant secretary shall have such powers and shall perform such duties as may be assigned to him by the Board of Directors or by the Finance Committee.

SECTION 10. Comptroller. The Comptroller shall be the principal officer in charge of the accounts of the Company, and shall perform such duties as from time to time may be assigned to him by the Board of Directors or the Finance Committee.

SECTION 11. Voting upon Stocks. Unless otherwise ordered by the Board of Directors or by the Finance Committee, the Chairman of the Board or the Chairman of the Finance Committee shall have full power and authority in behalf of the Company to attend and to act and to vote at any meetings of stockholders of any corporation in which the Company may hold stock, and at any such meeting shall possess and may exercise any and all the rights and powers incident to the ownership of such stock, and which, as the owner thereof, the Company might have possessed and exercised if present. The Board of Directors or the Finance Committee, by resolution, from time to time, may confer like powers upon any other person or persons.

ARTICLE V

CAPITAL STOCK—SEAL

SECTION 1. Certificates of Shares. The certificates for shares of the capital stock of the Company shall be in such form, not inconsistent with the certificate of incorporation, as shall be prepared or be approved by the Board of Directors. The certificates shall be signed by the president or a vice-president, and also by the treasurer or an assistant treasurer.

All certificates shall be consecutively numbered. The name of the person owning the shares represented thereby, with the

number of such shares and the date of issue, shall be entered on the Company's books.

No certificate shall be valid unless it is signed by the president or a vice-president, and by the treasurer or an assistant-treasurer.

All certificates surrendered to the Company shall be canceled, and no new certificate shall be issued until the former certificate for the same number of shares of the same class shall have been surrendered and canceled.

SECTION 2. *Transfer of Shares.* Shares in the capital stock of the Company shall be transferred only on the books of the Company by the holder thereof in person, or by his attorney, upon surrender and cancellation of certificates for a like number of shares.

SECTION 3. *Regulations.* The Board of Directors, and the Finance Committee also, shall have power and authority to make all such rules and regulations as respectively they may deem expedient, concerning the issue, transfer and registration of certificates for shares of the capital stock of the Company.

The Board of Directors or the Finance Committee may appoint a transfer agent and a registrar of transfers, and may require all stock certificates to bear the signature of such transfer agent and of such registrar of transfers.

SECTION 4. *Closing of Transfer Books.* The stock transfer books shall be closed for the meetings of the stockholders, and for the payment of dividends, during such periods as from time to time may be fixed by the Board of Directors or by the Finance Committee, and during such periods no stock shall be transferable.

SECTION 5. *Dividends.* The Board of Directors may declare dividends from the surplus or from the net profits of the Corporation.

The dates for the declaration of dividends upon the preferred stock and for the declaration of regular dividends upon the common stock shall be the days by these by-laws fixed for the regular monthly meetings of the Board of Directors in the months of April, July, October and January in each year, on which days the Board of Directors in

its discretion shall declare what, if any, dividends shall be declared upon the preferred stock and the common stock or either of such stocks; but upon any day by these by-laws fixed for a regular meeting of the Board of Directors in any month or upon any day upon which a special meeting of the Board of Directors shall be held in accordance with the provisions of these by-laws, the Directors may declare an extra dividend on the common stock of the Corporation out of the surplus or net profits of the Corporation existing at the end of the last quarter for which a full dividend upon the preferred stock was declared, provided all cumulative dividends upon the preferred stock for all previous years shall have been declared and shall have become payable, and the accrued quarterly instalments for the current year shall have been declared and the Corporation shall have paid such cumulative dividends for previous years and such accrued quarterly instalments, or shall have set aside from its surplus or net profits a sum sufficient for the payment thereof.

The dividends upon the preferred stock, if declared, severally and respectively, shall be payable quarterly upon the day preceding the last day of May, of August, of November and of February in each year.

The dividends upon the common stock, if declared upon the days fixed by these by-laws for the declaration of regular dividends upon the common stock, severally and respectively, shall be payable quarterly on the day preceding the last day of June, of September, of December and of March in each year; and if any extra dividends shall be declared at any other time, they shall be payable upon such date or dates as may be determined by the Board of Directors.

If the date herein appointed for the payment of any dividends shall in any year fall upon a legal holiday, then the dividends payable upon such date shall be paid upon the next preceding day not a legal holiday.

SECTION 6. *Working Capital.* The directors shall not be required in January in each year, after reserving over and above its capital stock paid in, as a working capital for said corpora-

tion, such sum, if any, as shall have been fixed by the stockholders, to declare a dividend among its stockholders of the whole of its accumulated profits exceeding the amount so reserved, and pay the same to such stockholders on demand; but the Board of Directors may fix a sum which may be set aside or reserved, over and above the Company's capital paid in, as a working capital for the Company, and from time to time they may increase, diminish and vary the same in their absolute judgment and discretion.

**Working
Capital.**

SECTION 7. *Corporate Seal.* The Board of Directors shall provide a suitable seal, containing the name of the Company, which seal shall be in charge of the secretary. If and when so directed by the Board of Directors or by the Finance Committee, a duplicate of the seal may be kept and be used by the treasurer or by any assistant secretary or assistant treasurer.

**Corporate
Seal.**

ARTICLE VI

AMENDMENTS

SECTION 1. The Board of Directors shall have power to make, amend and repeal the By-Laws of the Company, by vote of a majority of all of the Directors, at any regular or special meeting of the Board, *provided* that notice of intention to make, amend or repeal the By-Laws in whole or in part shall have been given at the next preceding meeting; or without any such notice, by a vote of two-thirds of all the directors.

**Amend-
ments.**

Voting Trusts. — The forms necessary for the organization of a stockholders' voting trust are the trust agreement and the voting trustees' certificates. A single specimen of each of these is here reproduced.

FORM 30

VOTING TRUST AGREEMENT¹

We, the Undersigned, stockholders of the Glen Harbor Improvement Company, a corporation duly organized under the laws of the State of New York, and having its principal office in the City of Yonkers, in the State of New York, do hereby, in consideration of the premises and of our mutual undertakings as herein set forth, severally agree to transfer and deliver the shares of stock held by each of us in said corporation, to Emmett M. Brown, William Swift, and Andrew McBride, all of the said City of Yonkers, as Voting Trustees hereunder, and mutually agree with them and with each other that said Trustees shall hold and vote the said stock for the period of five years from the date hereof, for the purpose and under the following terms and conditions:

1. All stockholders of the said Company may join in the voting trust hereby created, by signing this present agreement and transferring, in whole or in part, the shares of stock held by them in said Company to the said Trustees, under the conditions and for the purposes of this present agreement.

2. Each stockholder in said Company joining this voting trust as afore provided shall become a party thereto from the date on which stock owned by such stockholder in said Company shall be transferred and delivered to said Trustees for the purposes of this agreement.

3. The said Trustees shall surrender to the proper officer of the said Glen Harbor Improvement Company, for cancellation, the certificates for all shares of stock transferred to said Trustees, and shall, in place thereof, have certificates of said Company issued to themselves as Trustees, and on the face of each said Trustees' certificate shall be stated the fact that such certificate has been issued pursuant to this agreement.

4. The said Trustees shall collect and receive all dividends and

¹ From Conynghton, *Corporate Organization and Management*, pp. 606-607.

profits accruing to said stock and shall pay over the same to the respective owners thereof.

5. The said Trustees shall issue to each stockholder becoming a party thereto one or more transferable Trustees' receipts for the number of shares of stock placed by each of said stockholders respectively in this voting trust, and when such Trustees' receipts are duly transferred to other parties, said Trustees shall recognize such other parties as the lawful assigns and successors of the original parties hereto, entitled to all of their rights in the premises.

6. The stock held under this agreement shall, except as herein-after specially provided, be voted at any meeting of the stockholders of said Company by such of the said Trustees as may be present thereat, and said vote shall be cast as in the judgment of a majority of the said Trustees present at any such meetings may be for the best interest of the stockholders subscribing to this agreement.

7. In all elections of Directors the said stock shall be voted for the re-election of the present members of the Board of Directors of said Company, or, in the event of death, disability, or refusal to serve of any such members, the said stock shall be voted for such other person or persons as, in the judgment of said Trustees, shall be the most suitable for such office.

8. This agreement shall terminate five years from the date hereof, and upon such termination the said Trustees shall, as the outstanding Trustees' receipts are surrendered to them, duly indorsed, give over to the said Company the certificates of stock held by said Trustees, in pursuance of this agreement, properly indorsed, and shall direct the officers of said Company to deliver to the respective owners of the said surrendered Trustees' receipts certificates for such numbers of shares of stock as may be necessary to satisfy the requirements of the said surrendered Trustees' receipts.

9. In the event of the death, disability, resignation, or refusal to act of any of the Trustees herein named, the remaining Trustees, or Trustee, shall have power to suitably fill such vacancy or vacancies, and the person or persons so appointed shall be empowered and authorized to act hereunder in all respects as if originally named herein.

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10. A duplicate of this agreement shall be filed in the principal office of the said Company in Yonkers and shall there be kept for the inspection of any Stockholder of the Company, daily, during business hours.

IN TESTIMONY WHEREOF, the parties to this agreement have hereunto affixed their hands and seals in the said City of Yonkers this 27th day of February, 1917.

<i>Voting Trustees</i>	<i>Stockholders</i>	<i>Shares Transferred</i>
Emmett M. Brown (L. S.)	James Halsey (L. S.)	50
William Swift (L. S.)	Ernest Jurgens (L. S.)	125
Andrew McBride (L. S.)	Harold M. Gilsey (L. S.)	75
	Willis M. Ames (L. S.)	75

FORM 31

VOTING TRUSTEES' CERTIFICATE

Organized Under the Laws of the State of New York

Number.....Shares

CONSOLIDATED CLOTHING COMPANY

Capital Stock \$500,000

*Certificate for Stock Deposited Under Voting Trust
Agreement of June 8, 1921.*

H. B. Smith, Max Engels, and William J. Friedman, Trustees, by the Trust Company, their agent, having received on deposit the entire capital stock of the Consolidated Clothing Company, full-paid and non-assessable, all being held under the above-named agreements, to the terms of which the holder hereof assents by receiving this certificate, certify that is entitled, subject to the provisions of said Agreement, to Fifty Shares of the stock deposited thereunder. This certificate entitles the holder to all rights, dividends and privileges belonging to the actual stock, excepting only the right to

vote. The Trusteeship herein agreed to may be terminated after three years upon the terms set forth in the above named agreement and is ended by limitation in five years from date of agreement.

Transferable only on the books of the undersigned at the office of the Trust Company, New York City, by the holder hereof in person or by duly authorized attorney, upon surrender of this certificate properly indorsed.

(Dated)

H. B. SMITH

MAX ENGELS

WILLIAM J. FRIEDMAN,
Trustees

By Trust Company,
Depository and Agent,

By A. O. Henry, *Secretary*.

The assignment on the back of the certificate should read about as follows:

For value received, I hereby sell, assign, and transfer to the interest in the stock of the Consolidated Clothing Company represented by the within certificate, and do hereby irrevocably constitute and appoint.....my attorney to transfer the said interest on the books of the within named Trustees with full power of substitution in the premises.

(Date)

(Signature)

.....

.....

Meetings of Stockholders and Directors.— It is important that there be no irregularity in the way in which meetings of stockholders or directors have been called and notified, otherwise the action taken at such meetings may be held to be invalid and not binding upon the corporation. The ordinary rule is that the stockholders and directors must be notified of any meeting that has been called a certain minimum number of days in advance of the time set for the meeting. In the case of special meetings it is also necessary to include in the notice a statement of all

matters or questions that are to come up for consideration. Meetings may, of course, be called and notice waived by consent of all the members of the body. This method is commonly used in calling the first meeting of stockholders and directors upon organizing a corporation. The following forms are illustrative of these points.

FORM 32

CALL AND WAIVER TO BRING TOGETHER FIRST
MEETING OF STOCKHOLDERS

We, the undersigned, being all of the incorporators and stockholders of the Fit-Well Clothing Company, do hereby call the first meeting of the stockholders thereof, to be held in the office of H. Lyon, 37 Wall Street, New York City, June 16, 1921, at 10 o'clock A.M., for the organization of the company and the transaction of all such business as may be incident thereto, and we hereby waive all requirements as to notice of such meeting and consent to the transaction thereat of any and all business pertaining to the affairs of the company.

JULIUS GOLDSTEIN
MAX ENGELS
WILLIAM J. FRIEDMAN
A. L. ROBBINS
JOHN GOLDEN

New York, June 16, 1921.

In states that do not require the directors for the first year to be named in the charter, the call and waiver for the first meeting of stockholders usually sets forth the purposes as follows:

“for the purpose of receiving charter, electing directors, adopting by-laws and the transaction of such other business as may be incident or necessary to the organization of the company.”

The call and waiver for first meetings of directors is similar to the above except in the statement of purposes which are usually given somewhat as follows:

“for the purpose of electing officers of the company, acting upon a proposition to exchange stock for property, and doing all such other things as may be necessary or desirable in connection with the organization of the company or for the promotion of its business.”

FORM 33

NOTICE OF REGULAR OR ANNUAL MEETING OF
STOCKHOLDERS

MANHATTAN RAILWAY COMPANY,
No. 165 Broadway, New York.

The Annual Meeting of the Shareholders of the Manhattan Railway Company will be held at the Company's office, No. 165 Broadway, Manhattan Borough, New York City, on Wednesday, November 10th, 1920, at 12 o'clock Noon.

A Board of Directors for the ensuing year is to be elected, and three Inspectors of Election.

The transfer books will not close.

ALFRED SKITT, *President.*

P. V. TRAIQUE, *Asst. Secretary.*

October 7th, 1920.

The above is the simplest form of notice that can be used. It is, however, quite common to state the qualifications of voters somewhat more definitely than in this case. For example, a notice to the stockholders of the Gulf States Steel Company contains the following:

“The books for the transfer of the stock of the Company will not be closed, but no stock can be voted at said meeting which shall have been transferred on the books of the Company during the period of twenty days prior to said meeting.”

The Illinois Central Railroad Company, in closing its stock transfer books before an election gives notice of this to stockholders in the call and notice.

"For the purpose of the Annual Meeting of Stockholders of the Illinois Central Railroad Company, to be held at Chicago, Ill., on Wednesday, April 20, 1921, the Stock Transfer Books will be closed at 3 P.M. on Wednesday, April 6, 1921, and will remain closed until the morning of Thursday, April 21, 1921.

Special matters of considerable importance, but somewhat outside of the ordinary run of affairs, are usually mentioned in the notice to stockholders if they are to be brought up at the meeting.

Special meetings of stockholders may be called (1) by the chief executive officers of the company, usually the president and the secretary, (2) by a stated per cent of the stockholders, (3) by all of the stockholders by means of a call and waiver of notice or (4) by resolution of the directors. In any event the notice and call must state fully the purpose of the meeting, and no matters other than those enumerated in the notice and call may be considered.

FORM 34

PRESIDENT'S CALL FOR SPECIAL MEETING OF STOCKHOLDERS

Mr. L. Landau,

Secretary of the Liberty Merchandise Co., Inc.

You are hereby authorized and directed to send out notice of a special meeting of the Stockholders of this Company, hereby called by me, said meeting to be at No. 106 Forsyth St., New York City, on the 18th day of November, 1920, at 10 o'clock A.M., for the purpose of considering and acting upon a proposition to increase the capital stock from \$12,500 to \$50,000, at \$25.00 a share, and for the transaction of any and all business in connection therewith that may properly come before said meeting.

(Date)

J. SILVERMAN,
President.

The Secretary will thereupon send out a notice as follows:

LIBERTY MERCHANDISE Co., Inc.
295 Broome St.

Notice is hereby given to all the stockholders of the above corporation that a special meeting will take place on the 18th day of November, at 106 Forsyth St., New York City, at 10 o'clock A.M. for the purpose of considering a proposition to increase the capital stock of the Company from \$12,500 to \$50,000, at \$25.00 a share and for the transaction of any and all business in connection therewith that may properly come before said meeting.

J. SILVERMAN, *Pres.*
L. LANDAU, *Secy.*

FORM 35

STOCKHOLDERS' REQUEST FOR SPECIAL MEETING

To the Secretary of the

A..... B..... Co.

We, the undersigned, stockholders of the A..... B..... Company owning and controlling not less than two-thirds (*or such amount as the by-laws may provide*) of its entire voting stock, do hereby call a special meeting of the stockholders of the Company to be held at at o'clock, on day of, 19...., for the purpose of

(Date)	Names	Shares Owned.
.....		
.....		
.....		

The formal notice is thereupon sent out by the secretary.

FORM 36

SPECIAL MEETING OF STOCKHOLDERS BY CALL AND
WAIVER

We, the undersigned, being all the stockholders of the A.....
B..... Company, hereby call a special meeting of the stock-
holders of said Company to be held in the Company's offices at
....., on day of, 1921, at o'clock, for
the purpose of considering (etc.)

(Date)

(Signed by all stockholders in person
or proxy).

A special meeting by call and waiver is, of course, useful
only where the number of stockholders is small, conse-
quently it is seldom used by large corporations.

FORM 37

DIRECTORS' RESOLUTION FOR SPECIAL MEETING

Be It Resolved, That a special meeting of the stockholders of
this Company be and hereby is called, said meeting to be held
in the offices of the Company at on the day of
....., 1921, at o'clock for the purpose of (etc.)

In all cases, except where the meeting is by call and
waiver, the secretary sends out the official notice similar to
that given in Form 34.

Special meetings of directors may be called by the presi-
dent of the company or chairman of the board of directors,
by a stated number of the directors themselves, or by call
and waiver of all of the directors. The forms differ little
from those pertaining to special meetings of the stock-
holders.

Proxies may be given by stockholders to others to represent them and to vote their stock at meetings. They may be (1) general in their authority and unlimited as to time, (2) limited as to time and general in authority, and (3) limited in both respects. They must bear a government revenue stamp to be valid.

FORM 38

GENERAL AND UNLIMITED PROXY

I, hereby appoint Benjamin M. Squires my proxy with full authority to vote for me and in my place at any and all stockholders' meetings of the Urban Motion Picture Industries, Inc.

Witness my hand and seal this 7th day of October, 1920.

A. H. Stockder (L. S.)

Witnessed by

G. A. Betz.

Where the proxy is to be limited in any particular, such limitation must be clearly set forth in the grant of authority. In such cases it is usually somewhat more formal. When a corporation designates someone as proxy to vote in meetings of stockholders of a corporation whose stock it holds, the proxy must bear the official signature and seal of the corporation appointing the proxy.

FORM 39

REVOCATION OF PROXY

Know All Men By These Presents:

That I, the undersigned, do hereby revoke and annul any and all proxies or powers of attorney heretofore given by me, authorizing or empowering any person or persons to represent me, or vote for me or in my name or stead or act for me in any

way whatsoever at any meeting or meetings of the stockholders of the A..... B..... Corporation.

Witness my hand and seal this day of, 1921.

In the presence of
 Signature (L. S.)

Election Forms.—In holding elections of directors, and officers of the corporation it is essential that the whole procedure conform in all respects to statutory, charter and by-law requirements. In New York and other states an oath is prescribed for inspectors of election and also a form of an inspectors' certificate of election.

FORM 40

OATH OF INSPECTORS OF ELECTION

State of New York, County of New York, ss:

We, the undersigned, duly appointed to act as inspectors of election at the annual meeting of stockholders of the Company, No. Street, in the City of New York, on the day of 19...., being severally sworn, depose and say, and each for himself deposes and says, that he will faithfully execute the duties of inspector of election at such meeting with strict impartiality and according to the best of his ability.

JOHN SMITH
 WILLIAM JAMES

Subscribed and severally sworn to before me this day of 19....

(Notarial Seal)

ALFRED MARSH,
Notary Public.

FORM 41

INSPECTORS' CERTIFICATE OF ELECTION

The undersigned inspectors of election, duly appointed and qualified, do hereby certify that at the regular annual meeting of stockholders of the Company, held at the office of said company, No. Street, New York, on the day of, 19...., a quorum being present, we, after being first duly sworn by oath hereto annexed, did conduct the election for directors of said corporation, and that the vote taken thereat resulted in the election, by the plurality set opposite their respective names, of the following directors to serve for the ensuing year.

<i>Names</i>	<i>Votes Received</i>
John Johnson	125
George Williams	108
Charles Wilson	117
Witness our hands this day of, 19....	

WILLIAM SPRUCE.

JOHN JACOBS.

STATE OF NEW YORK, COUNTY OF NEW YORK, ss:

Before me, a notary public, on this day of, 19...., personally appeared William Spruce and John Jacobs, to me well known to be persons described in and who executed the foregoing certificate, and severally acknowledged that they executed the same for the uses and purposes therein set forth.

MARTIN MARKS,

(Notarial Seal.) Notary Public for County of New York.

FORM 42

NOTICE OF ELECTION AS DIRECTOR

FIT-WELL CLOTHING CORPORATION,
NEW YORK CITY.

Dear Sir:

You are hereby notified that at the annual meeting of the stockholders of the Fit-Well Clothing Corporation held on, 19...., you were elected a member of its Board of Directors.

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The next regular meeting of the Board will be held in the office of the Company, at o'clock , for the election of officers and for the transaction of such other business as may come before the meeting.

You are requested to be present and take part in that meeting.

Respectfully,

.....

Secretary.

FORM 43

OATH OF OFFICERS

STATE OF, COUNTY OF, ss:

I, ..., being first duly sworn, on oath declare that I am a bona fide stockholder of the Union Cereal Company, and that at a regular (*or special*) meeting of the board of directors of said corporation, called and held in accordance with the laws of the state of and the articles of incorporation and by-laws of the said corporation on the day of, 19...., I was duly and regularly elected to the office of president (or other office) and that I accept the trust imposed in me by said election; and I promise and swear that during all the time of holding said office I will support and obey the Constitution and laws of the United States, the constitution and laws of the state of, and the articles of incorporation and by-laws of said corporation, and will at all times faithfully, impartially and diligently perform and carry out the duties of said office to the best of my ability.

(Signed)

Subscribed and sworn to before me this day of
....., 19....

.....,

Notary Public in and for the state of, etc.

FORM 44

TREASURER'S BOND

Know All Men By These Presents:

That We, Max Engels of New York City, as principal, and William H. Flint, of New York City, and John H. Strong of Brooklyn, New York, as sureties, are held firmly bound unto the Fit-Well Clothing Corporation, duly organized under the laws of the State of New York, in sum of Five Thousand Dollars (\$5,000), to the payment of which to the said corporation, its successors, or assigns, we do by these presents jointly and severally bind ourselves, our heirs, executors, and administrators. ministrators.

Signed and sealed this 23rd day of June, 1921.

The condition of the above obligation is that:

Whereas, the said Max Engels has been elected Treasurer of the said Fit-Well Clothing Corporation for the period of one year from the 23rd day of June, 1921, and may hereafter be re-elected to continue in such office for a further period:

Now, Therefore, If the said Max Engels shall hereafter in all respects fully, faithfully, and honestly perform and discharge the duties of said office so long as he shall continue therein, both during the term for which he has been elected and during such further time as he may continue therein, whether by re-election or otherwise, and shall when properly so required, fully and faithfully account to the said Corporation, its successors, or assigns, for all moneys, goods, and properties whatsoever, for or with which the said Max Engels may in any wise be accountable or beholden to the said Corporation, and if at the expiration of his term of or continuance in office, or prior thereto in the event of his death, resignation or removal from office, all books, papers, vouchers, money, and other property of whatsoever kind placed in his custody as Treasurer of said Corporation, shall be forthwith restored to the said Corporation, its successors, or assigns, then this obligation shall be void, but otherwise to remain in full force and effect.

Signed, sealed and delivered

in the presence of

JOHN A. SMITH,

HENRY Z. JONES.

MAX ENGELS (L. S.)

WILLIAM H. FLINT (L. S.)

JOHN H. STRONG (L. S.)

Dividends and Financial Matters.— Dividends are declared by resolution of the board of directors out of the net earnings of the corporation. Such a resolution may simply set aside and appropriate a stated sum to be used to pay a stipulated dividend on all classes of stock outstanding, or it may declare a dividend of a specified per cent to be paid out of the net earnings on each class of stock, respectively. In any case it should direct the treasurer to give notice of the dividend and to pay it when it is due to stockholders of record as of a specified day.

FORM 45

DIRECTORS' RESOLUTION DECLARING DIVIDEND

Resolved, That the sum of Five Thousand Dollars (\$5,000) be and hereby is appropriated and set aside from the surplus profits of this company for the payment of the regular One and Three Quarters Per Cent ($1\frac{3}{4}\%$) quarterly dividend upon its outstanding stock, said dividend to be due and payable on the 1st day of April, 1921, to the stockholders of record as shown by the books of the Company at the close of business on the 15th day of March.

Resolved Further, That the Treasurer of this Company be hereby authorized and instructed to give due notice of such dividend and to pay the same when due.

FORM 46

RESOLUTION DECLARING DIVIDEND ON PREFERRED STOCK ONLY

Resolved, That the semi-annual dividend of Three Per Cent (3%) upon the outstanding Preferred Stock of the Company be and hereby is declared from the surplus profits, said dividend to be paid on the first day of December, 1920, at the Liberty National Bank, 120 Broadway, New York City, to holders of record

at the close of business, Thursday, November 11, 1920, and that the Treasurer of this Company be hereby instructed and fully authorized to give the same on the date set forth.

If the stock has no par value the resolution states the amount of the dividend to be paid on each share in dollars and cents as follows:

Resolved, that a regular quarterly dividend of One Dollar and Fifty Cents (\$1.50) on each share of Common Stock outstanding be and hereby is declared, payable, etc.

FORM 47

TREASURER'S NOTICE OF DIVIDEND

AMERICAN HIDE & LEATHER Co.

NEW YORK, October 26, 1920.

A dividend of $1\frac{3}{4}\%$ has this day been declared upon the preferred capital stock of the company, payable out of the accumulated net profits arising from the business of the Corporation, payable on January 3, 1921, to stockholders of record at the close of business December 11, 1920.

GEO. A. HILL, *Treasurer*.

FORM 48

NOTICE OF DIVIDEND IN FORM OF PROPERTY

HOCKING VALLEY PRODUCTS COMPANY.

Dividend No. 1.

The Board of Directors of the Hocking Valley Products Company at a meeting held on October 21st, 1920, have declared out of the net earnings and profits of the company for and during the year 1920 a dividend of 5% upon the capital stock of the Company as now authorized and constituted, such dividend to be payable, however, only in United States of America Fourth Liberty $4\frac{1}{4}\%$ Bonds with coupon due April 15th, 1921, and subsequent coupons attached.

The said dividend shall be payable on November 18th, 1920,

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to the stockholders of record at the close of business on November 8th, 1920.

Where the amount of any dividend payment, or any part thereof, is not Fifty Dollars (\$50.), or a multiple thereof, payment shall be made in cash on the basis of 90% as the current market price of such goods instead of in said bonds.

The books of the Company will be closed on November 8, 1920, and remain closed until the opening of business on November 19th, 1920.

Such dividend is payable only upon and in respect to the present authorized capital stock of the company of the par value of \$10 each per share, and stockholders having voting Trust Certificates, or former stock of the Company of \$100 per share par value, or \$20 per share par value, are requested to take proper steps for exchange of such certificates or stock into the present authorized and existing capital stock of the Company.

S. L. CHAMBERLAIN, *President.*

FORM 49

FINANCIAL STATEMENT OF A CORPORATION

PETTIBONE MULLIKEN Co.

General Balance Sheet, December 31, 1918.

ASSETS

Real estate, factory, etc.	\$1,499,989
Patents & good-will	6,201,448
Deferred charges	
<i>Current assets —</i>	
Cash	\$811,339
Treasury securities	350,957
Notes Receivable	35,500
Accounts receivable	553,572
Inventories	710,684
U. S. Liberty Loan Bonds	100,750
Total current assets	2,562,802
Total assets	\$10,264,239

LIABILITIES

First pfd. stock	\$1,000,000
Second pfd. stock	750,000
Common stock	7,000,000
Special surplus .....	.....
Profit and loss surplus	1,166,382
<i>Current liabilities —</i>	
Accounts payable	\$ 97,857
Reserve for taxes, etc.	250,000
Total current liabilities	\$347,857
Total liabilities	\$10,264,239

Corporate Signatures. — In general business transactions the corporation may be bound by the signature of its duly appointed agents in all matters delegated to them. In the more important transactions the “official signature” of the corporation is necessary, and in all legal and formal documents and contracts the “corporate signature” should be used with the seal.

FORM 50

OFFICIAL SIGNATURE

JULIUS GOLDSTEIN,
President.

or more formally

JULIUS GOLDSTEIN,
President, Fit-Well Clothing
Corporation.

FORM 51

CORPORATE SIGNATURE—INFORMAL

FIT-WELL CLOTHING CORPORATION,
By JULIUS GOLDSTEIN,
President,

(In the above a rubber stamp is sometimes used and the signature of the president filled in in writing).

FORM 52

CORPORATE SIGNATURE—FORMAL

(Corporate) PETTIBONE MULLIKEN COMPANY,
(Seal) By A. H. MULLIKEN, *President*
H. R. PREST, *Secretary.*

The signatures to formal instruments are usually preceded by a "testimonium clause" as follows:

In Witness Whereof, the said Pettibone Mulliken Company has caused its corporate name to be hereunto subscribed by its President and its duly attested corporate seal to be hereunto affixed by its Secretary, all in the City of Chicago, State of Illinois, on the 22nd day of August, 1918.

(Corporate) PETTIBONE MULLIKEN COMPANY,
(Seal) By A. H. MULLIKEN,
Attest Seal: *President.*
H. R. PREST,
Secretary.

Sale of Assets and Dissolution.—A sale of the entire assets of the corporation must ordinarily be authorized by a two-thirds or a three-quarters majority of all of the stockholders. Upon such authorization the board of directors will draft and make a resolution to carry out the wishes of the stockholders.

FORM 53

STOCKHOLDERS' RESOLUTION FOR SALE OF ENTIRE ASSETS

Whereas, A. M. Lord as Trustee before the organization of the Consolidated Clothing Company, has made a proposition to purchase the entire plant and business of this company as a going concern, including all assets and liabilities, save cash in bank and on hand, for Five Thousand Dollars (\$5,000) in cash and Fifty Thousand Dollars (\$50,000) par value of the Consolidated Clothing Company.

Now, Therefore, Be It Resolved, That the said proposition be hereby approved, and that the Directors of this Company be and hereby are fully authorized, instructed, and empowered to accept the said proposition for sale of its entire property and business, and to do all things necessary to carry such acceptance into effect according to the terms of said proposition.

FORM 54

DIRECTORS' RESOLUTION FOR SALE OF ENTIRE ASSETS

Whereas, A proposition has been made by the Trustee of the Consolidated Clothing Company to purchase the entire property and business of this Company for Five Thousand Dollars (\$5,000) in cash and Fifty Thousand Dollars (\$50,000) in stock of the said proposed corporation as set forth in his written proposition heretofore ordered to be spread upon the minutes of this meeting; and

Whereas, The Stockholders of this company in duly assembled meeting at which all the voting stock of the Company was represented in person or by proxy, did by resolution unanimously carried, approve said sale and authorize and instruct this Board to accept said proposition:

Now, Therefore, Be It Resolved, That the said proposition be and the same is hereby accepted by this Company on the terms set forth in said written proposition as entered upon the minutes of this meeting, and the President and Secretary of the Company

are hereby empowered and instructed to execute all proper instruments to carry such acceptance into effect, and on behalf of this Company to receive the said Five Thousand Dollars (\$5,000) in cash and Fifty Thousand Dollars (\$50,000) in stock of the said Consolidated Clothing Company, and to do all such other things in connection with such sale and the said transfer of property as may be found necessary for its proper consummation.

A private business corporation may be dissolved in any one of the following ways: (1) expiration of the charter, (2) repeal of the charter by the legislature, (3) by voluntary action of the corporation, (4) by forfeiture for violation of the law, and (5) through the death of all of its stockholders in the absence of heirs.

The procedure to be followed in case of voluntary dissolution is clearly defined in the corporation statutes of each state. It must be authorized by resolution of the Stockholders and carried out by the directors in a manner similar to that set forth for the sale of the entire assets. This procedure varies considerably, but in all cases official notice must be given by a proper state authority.

FORM 55

NOTICE OF DISSOLUTION

STATE OF NEW YORK, OFFICE OF THE SECRETARY OF STATE ss:

This certificate issued in duplicate, hereby certifies that the Haster Columbus Company, Inc., a domestic stock corporation, has filed in this office on this 26th day of February, 1921, papers for the voluntary dissolution of said corporation under section 221 of the General Corporation Law, and that it appears therefrom that such corporation has complied with said section in order to be dissolved.

WITNESS my hand and the seal of office of the Secretary of State, at the City of Albany, this twenty-sixth day of February, one thousand nine hundred and twenty-one.

(Seal)

A. B. PARKER, *Deputy Secretary of State.*

3. THE BUSINESS TRUST

FORM 56

AGREEMENT AND DECLARATION OF TRUST OF THE
MASSACHUSETTS GAS COMPANIES

THIS AGREEMENT, made this twenty-fifth day of September, A.D. nineteen hundred and two, by and between Charles Francis Adams, 2nd, Walter Cabot Baylies, Samuel Carr, Robert Clarence Pruyn, Joseph Ballister Russell, Frederic Elmer Snow, Charles Augustus Stone, Albert Strauss, Christopher Minot Weld, and Robert Winsor, together with their successors (herein designated as the "Trustees"), and Francis H. Peabody, Frank G. Webster, Frank E. Peabody, and Robert Winsor, co-partners, carrying on business in the city of Boston under the name of Kidder, Peabody & Company, and James Seligman, Isaac N. Seligman, Henry Seligman, Jefferson Seligman, Emil Carlebach, Albert Strauss, and Frederick Strauss, co-partners carrying on business in the city of New York under the name of J. & W. Seligman & Company, together with their assigns (herein designated as the "Subscribers"), witnesseth:

WHEREAS it is proposed that the Trustees shall acquire from the subscribers, upon such terms and conditions as may be agreed upon, certain property and cash, and shall employ and manage the same and all other property which they may hereafter acquire as such Trustees, in the manner hereinafter stated; and it is likewise proposed that the beneficial interest in the property, from time to time held by the Trustees, and in the business conducted by them, shall be divided into shares to be evidenced by certificates therefor, as hereinafter provided:

NOW, THEREFORE, the Trustees hereby declare that they will hold said property and cash so to be acquired by them, as well as all other property which they may acquire as such Trustees, together with the proceeds thereof, in trust, to manage and dispose of the same for the benefit of the holders, from time to time of the certificates of shares issued and to be issued hereunder, according to the priorities expressed in said certificates, and in the manner and subject to the stipulations herein contained, to-wit:

FIRST. The Trustees, in their collective capacity, shall be designated, so far as practicable, as the "Massachusetts Gas Companies" and under that name shall, so far as practicable, conduct all business and execute all instruments in writing, in the performance of their trust.

SECOND. The Trustees shall be ten in number; and, of the Trustees herein mentioned by name, Charles Francis Adams, 2nd, Walter Cabot Baylies, Samuel Carr, Robert Clarence Pruyn, and Joseph Ballister Russell shall hold office until the first annual meeting of the shareholders, and Frederic Elmer Snow, Charles Augustus Stone, Albert Strauss, Christopher Minot Weld and Robert Winsor shall hold office until the second annual meeting of the shareholders, except that said Trustees, as well as any Trustees hereafter elected, shall in all cases hold office until their successors have been elected, and accepted this trust.

The shareholders shall, at each annual meeting, or adjournment thereof, elect five Trustees to serve for the term of two years next ensuing. In the case of the death, resignation, or inability to act of any of said Trustees, the remaining Trustees shall fill any vacancies for the unexpired term. As soon as any trustees elected by the shareholders or by the remaining Trustees to fill a vacancy have accepted this trust, the trust estate shall vest in the new Trustees or Trustee, together with the continuing Trustees, without any further act or conveyance.

Upon the election of any Trustee either by the remaining Trustees to fill a vacancy, or by the shareholders, he shall forthwith execute a written acceptance of this trust, which, together with a certificate of the Secretary of the election of such trustee shall be forthwith filed with the Trust Company at that time having the custody of the duplicate of the original of this instrument.

THIRD. The Trustees are authorized to engage —

(a) In the business of manufacturing, buying, selling and dealing in coal, oil, coke, gas and all products thereof;

(b) In the business of manufacturing and supplying gas or electricity or any other agent for light, heat, power, or other purposes;

(c) In the business of acquiring, owning, managing, exchanging, selling, and dealing in the stocks, shares and securities of cor-

porations, trusts or associations engaged, in whole or in part, in any business above mentioned, or in owning or operating railways or railroads or transporting passengers, merchandise, mails or express matter, or in manufacturing, selling or repairing machines, equipments, supplies, or other articles used by corporations, trusts or associations of any of the classes above mentioned, and or in the business of acquiring, owning, managing, exchanging, selling, or dealing in the stocks, shares or securities of any corporation, trust or association which owns, or whose stock or securities are based upon or secured by the stocks or securities of any corporation, trust or association of the character above mentioned;

(d) In any business similar in character to that above mentioned which the trustees may deem expedient, and to acquire, hold, and dispose of the stocks, shares or securities of corporations, trusts or associations doing business of a character similar to any business above described.

The Trustees shall hold the legal title to all property at any time belonging to this trust, and, subject only to the specific limitations herein contained, they shall have the absolute control, management, and disposition thereof, and shall likewise have the absolute control of the conduct of all business of the trust; and the following enumeration of specific duties and powers shall not be construed in any way as a limitation upon the general powers intended to be conferred upon them.

The Trustees shall have authority to adopt and use a common seal; to make all such contracts as they may deem expedient in the conduct of the business of the trust; from time to time to release, sell, exchange, or otherwise dispose of, at public or private sale, any or all of the trust property, whether real or personal, for such prices either in cash or the stock, shares, or securities of other corporations, trusts or associations and upon such terms as to credit or otherwise as they may deem expedient, to guarantee or assume the obligations of other corporations, trusts or associations and to enter into such agreements by way of indemnity or otherwise as they may deem expedient in connection with the acquisition of property from the subscribers as hereinbefore provided or otherwise; to confer, by way of substitution, such power and authority on the President, Treasurer, Secretary, and Executive Committee, and other officers and agents appointed by them,

as they may deem expedient; to borrow money for the purpose of the trust and give the obligations to the Trustees therefor; to loan any money from time to time in the hands of the Trustees, with or without security, on such terms as they may deem expedient; to subscribe for, acquire, own, sell, or otherwise dispose of such real or personal property, including the stocks, shares, and securities of any other corporations, trusts or associations, as they may deem expedient in connection with the purposes of the trust; to vote in person or by proxy on all shares of stock at any time held by them, and to collect and receive the income, interest, and profits of any such stock or securities; to collect, sue for, receive, and receipt for all sums of money at any time becoming due to said trust; to employ counsel and to begin, prosecute, defend, and settle suits at law, in equity or otherwise, and to compromise or refer to arbitration any claims in favor of or against the trust; and in general to do all such matters and things as in their judgment will promote or advance the business which they are authorized to carry on, although such matters and things may be neither specifically authorized nor incidental to any matters or things specifically authorized. In addition to the powers herein granted the Trustees shall have all powers with reference to the conduct of the business and management of the property of the trust which are possessed by directors of a manufacturing corporation under the laws of the Commonwealth of Massachusetts.

So far as strangers to the trust are concerned, a resolution of the Trustees authorizing a particular act to be done shall be conclusive evidence in favor of strangers that such act is within the power of the Trustees; and no purchaser from the Trustees shall be bound to see to the application of the purchase money or other consideration paid or delivered by or for said purchaser to or for the Trustees.

FOURTH. Stated meetings of the Trustees shall be held at least once a month, and other meetings shall be held from time to time upon the call of the President or any three of the Trustees. A majority of the Trustees shall not be necessary to the validity of any action taken by them, but the decision expressed by vote of a majority of the Trustees present and voting at any meeting shall be conclusive.

The Trustees may make, adopt, amend, or repeal such by-laws, rules, and regulations not inconsistent with the terms of this instrument as they may deem necessary or desirable for the conduct of their business and for the government of themselves, their agents, servants and representatives.

FIFTH. The Trustees shall annually elect from among their number a President, and shall also elect from among their number or otherwise, a Treasurer, a Secretary, and, in their discretion, one or more Vice-Presidents, and one or more Assistant Treasurers or Secretaries, and they shall have authority to appoint such other officers, agents, and attorneys as they may deem necessary or expedient in the conduct of their business. They shall also have authority to accept resignations and to fill any vacancies in the officers appointed by them, for the unexpired term, and shall likewise have authority to elect temporary officers to serve during the absence or disability of regular officers. They may also by a majority vote of all the Trustees, remove any officer or agent elected or appointed by them.

The President, Treasurer, and Secretary shall have the authority and perform the duties usually incident to those offices in the case of corporations, so far as applicable thereto, and shall have such other authority and perform such other duties as may from time to time be determined by the Trustees. The Trustees shall fix the compensation, if any, of all officers and agents whom they may elect or appoint, and may also pay to themselves such compensation for their own services as they may deem reasonable.

The Trustees may also appoint from among their number an Executive Committee of three or five persons, to whom they may delegate such of the powers herein conferred upon the Trustees as they may deem expedient.

The Trustees shall cause to be kept by the Secretary elected by them a record of all meetings of the shareholders, Trustees and Executive Committee, which record shall be of the same character and effect as that kept in the case of corporations, and so far as strangers to the trust are concerned, shall be conclusive against the Trustees of the facts and doings therein stated.

The Trustees shall not be liable for any error of judgment, or for any loss arising out of any act or omission in the execution of this trust, so long as they act in good faith, nor shall they be

personally liable for the acts or omissions of each other, or for the acts or omissions of any officer, agent, or servant elected or appointed by or acting for them; and they shall not be obliged to give any bond to secure the due performance of this trust by them.

Any Trustee may acquire, own, and dispose of shares in this trust to the same extent as if he were not a Trustee.

SIXTH. The beneficial interest in this trust shall, in the first instance, be divided into three hundred thousand (300,000) shares of the par value of one hundred (100) dollars each, of which one hundred and fifty thousand (150,000) shares shall be preferred and one hundred and fifty thousand (150,000) common.

The preferred shares shall entitle the holder to receive out of the net profits of the trust, a semi-annual, preferential, cumulative dividend at the rate of four per centum per annum, and no more, commencing to accrue on the first day of December, 1902, payable on the first days of June and December in each year, and to be paid or provided for before any dividend shall be set apart or paid on the common shares, provided that after the payment or setting aside of a semi-annual dividend on the preferred shares at the rate of four per centum per annum, all previously accrued dividends thereon having been paid or set aside, the Trustees may forthwith, without waiting for the expiration of the year, pay or set aside a semi-annual dividend on the common shares; and, in case of liquidation, the proceeds of liquidation shall be first applied to the payment to the holders of preferred shares of the sum of one hundred dollars per share and accrued and unpaid dividends thereon, and the balance remaining thereafter shall be divided among the holders of common shares in proportion to their holdings.

As evidence of the ownership of said shares the Trustees shall cause to be issued to each shareholder a negotiable certificate, or certificates, to be signed by such transfer agent or transfer agents and registrar or registrars as the Trustees may determine, and by the President or any Vice-President, and attested by any Secretary or Assistant Secretary, which certificates shall be in the form following, to-wit:

MASSACHUSETTS GAS COMPANIES

No.

*Preferred Shares.**Not subject to assessment.*

This certifies that.....
 is the holder of.....Preferred Shares in the
 Massachusetts Gas Companies, which he holds subject to an
 Agreement and Declaration of Trust dated September 25th, 1902,
 a duplicate original of which is on file with the.....
 Trust Company, and which is hereby referred to and made a
 part of this certificate.

The shares in the Massachusetts Gas Companies are of the
 par value of one hundred dollars each, and are divided into
 preferred and common shares.

It is mutually agreed between the holder hereof and the
 Massachusetts Gas Companies and its shareholders as follows:
 that the preferred shares are entitled out of the net profits of the
 Companies to a semi-annual, preferential, cumulative dividend
 at the rate of four per centum per annum, and no more, com-
 mencing to accrue on the 1st day of December, 1902, payable on
 the first days of June and December in each year, and to be paid
 or provided for before any dividend shall be set apart or paid
 on the common shares, provided that after the payment or
 setting aside of a semi-annual dividend on the preferred shares
 at the rate of four per cent per annum, all previously accrued
 dividends thereon having been paid or set aside, the Massachusetts
 Gas Companies may forthwith, without waiting for the expira-
 tion of the year, pay or set aside a semi-annual dividend on the
 common shares; that in the event of liquidation the proceeds of
 liquidation shall be first applied to the payment, to holders of
 the preferred shares, of the sum of one hundred dollars per share
 and accrued and unpaid dividends thereon, and the balance re-
 maining thereafter shall be divided among the holders of common
 shares in proportion to their holdings; that the holders of pre-
 ferred and common shares shall have equal voting powers, and
 that the preferred and common shares may be increased or re-
 duced as provided in the Agreement and Declaration of Trust
 herein referred to.

This certificate must be signed by the Transfer Agent and

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Registrar of the shares of the Massachusetts Gas Companies, who sign solely to indicate that the shares represented by this and all other outstanding certificates bearing their signatures do not exceed the issue of shares fixed by the votes of the Massachusetts Gas Companies.

No transfer hereof will be of any effect as regards the Massachusetts Gas Companies until this certificate has been surrendered and the transfer recorded upon their book.

IN WITNESS WHEREOF, the Trustees under said Declaration of Trust herein designated as the Massachusetts Gas Companies, have caused their common seal to be hereto affixed and this certificate to be executed in their name and behalf, by.....their President, and attested by their Secretary, this.....day of.....19...

MASSACHUSETTS GAS COMPANIES.

By..... *President*.

Attest:

By....., *Secretary*.

By....., *Transfer Agent*.

By....., *Registrar*.

By.....

NOTICE. — The signature to this assignment must correspond with the name as written upon the face of the certificate in every particular, without alteration or enlargement or any change whatever.

For value received
hereby sell, assign, and transfer
unto
..... preferred shares of
the Massachusetts Gas Com-
panies, represented by the
within certificate, and do hereby
irrevocably constitute and ap-
point
.....attorney, to trans-
fer the said shares on the books
of the within-named Com-
panies, with full power of sub-
stitution in the premises.

Witness.....hand this.....day of.....
In presence of.....

MASSACHUSETTS GAS COMPANIES

No.

*Common Shares.**Not subject to assessment.*

This certifies that.....
 is the holder of.....Common Shares in the
 Massachusetts Gas Companies, which he holds subject to an
 Agreement and Declaration of Trust dated September 25th, 1902,
 a duplicate original of which is on file with the Old Colony Trust
 Company, and which is hereby referred to and made a part of
 this certificate.

The shares in the Massachusetts Gas Companies are of the
 par value of one hundred dollars each, and are divided into
 preferred and common shares.

It is mutually agreed between the holder hereof and the
 Massachusetts Gas Companies and its shareholders as follows:
 that the preferred shares are entitled out of the net profits of
 the Companies to a semi-annual, preferential, cumulative dividend
 at the rate of four per centum per annum, and no more, com-
 mencing to accrue on the last day of December, 1902, payable
 on the first days of June and December in each year, and to be
 paid or provided for before any dividend shall be set apart or
 paid on the common shares, provided that after the payment
 or setting aside of a semi-annual dividend on the preferred
 shares at the rate of four per centum per annum, all previously
 accrued dividends thereon having been paid or set aside, the
 Massachusetts Gas Companies may forthwith, without waiting
 for the expiration of the year, pay or set aside, a semi-annual
 dividend on the common shares; that in the event of liquidation
 the proceeds of liquidation shall be first applied to the payment,
 to holders of the preferred shares, of the sum of one hundred
 dollars per share and accrued and unpaid dividends thereon, and
 the balance remaining thereafter shall be divided among the
 holders of common shares in proportion to their holdings; that
 the holders of preferred and common shares shall have equal
 voting powers; and that the preferred and common shares may
 be increased or reduced as provided in the agreement and Declara-
 tion of Trust herein referred to.

This certificate must be signed by the Transfer Agent and Registrar of the shares of the Massachusetts Gas Companies, who sign solely to indicate that the shares represented by this and all other outstanding certificates bearing their signatures do not exceed the issue of shares fixed by the votes of the Massachusetts Gas Companies.

No transfer hereof will be of any effect as regards the Massachusetts Gas Companies until this certificate has been surrendered and the transfer recorded upon their books.

IN WITNESS WHEREOF, the Trustees under said Declaration of Trust herein designated as the Massachusetts Gas Companies, have caused their common seal to be hereto affixed and this certificate to be executed in their name and behalf, by their President and attested by their Secretary, this..... day of 19...

MASSACHUSETTS GAS COMPANIES.

By.....*President*.

Attest:

By....., *Secretary*.

By....., *Transfer Agent*.

By....., *Registrar*.

By.....

NOTICE. — The signature to this assignment must correspond with the name as written upon the face of the certificate in every particular, without alteration or enlargement or any change whatever.

For value received hereby sell, assign, and transfer unto common shares of the Massachusetts Gas Companies represented by the within certificate, and do hereby irrevocably constitute and appoint attorney to transfer the said shares on the books of the within-named Companies, with full power of substitution in the premises.

Witness.....hand this.....day of.....
In presence of.....

SEVENTH. The shares hereunder shall be transferable by an appropriate instrument in writing and upon the surrender of the certificate therefor, but no such transfer shall be of any effect as regards the Trustees until it has been recorded upon the books of the Trustees kept for that purpose.

EIGHTH. The trustees shall issue to the Subscribers, or their assigns, certificates for said original three hundred thousand shares, in payment for and as evidence of their ownership of the beneficial interest in the property and cash proposed to be transferred to the Trustees by the Subscribers, as hereinbefore stated.

NINTH. For any of the purposes of the Trust the number of shares may from time to time, with the consent of the holders of not less than two-thirds of such of the shares as are represented and voted upon at any meeting called for that purpose, but not otherwise, be increased or reduced. In case the number of shares is increased, the additional shares shall be issued and disposed of upon such terms and in such manner as the shareholders at such meeting may determine, and in case of such increase such proportion of the new shares may be made preferred as the shareholders in authorizing such increase may determine.

TENTH. In case of the loss or destruction of any certificate for shares the Trustees may, under such conditions as they may deem expedient, issue a new certificate or certificates in place of the one lost or destroyed.

ELEVENTH. The Trustees may, with the consent of the holders of at least two-thirds of each class of shares outstanding, given at a meeting called for that purpose, but not otherwise, mortgage or pledge any property in their hands, upon such terms and for such purposes as the shareholders at such meeting may approve.

TWELFTH. The Trustees may from time to time declare and pay dividends out of the net earnings from time to time received by them but the amount of such dividends and the payment of them shall be wholly in the discretion of the Trustees, except that the dividends on the preferred shares shall be payable semi-

annually on the first day of June and December in each year, at the rate of four per centum per annum and no more, and shall be cumulative, and said semi-annual dividends shall be paid or set apart before any dividends are paid on the common shares.

THIRTEENTH. The fiscal year of the Trustees shall end on the first day of July in each year.

Annual meetings for the election of Trustees and for the transaction of other business shall be held in Boston, on the second Tuesday of October in each year, beginning with the year 1903, of which meetings notice shall be given by the Secretary by mailing such notice to each shareholder at his registered address at least ten days before said meeting.

Special meetings of the shareholders may be called at any time upon seven days' notice, given as above stated, when ordered by the President or Trustees.

At all meetings of the shareholders, each holder of shares, whether preferred or common, shall be entitled to one vote for each share held by him; and any shareholder may vote by proxy.

No business shall be transacted at any special meeting of the shareholders unless notice of such business has been given in the call for the meeting. No business, except to adjourn, shall be transacted at any meeting of the shareholders unless the holders of a majority of all the shares outstanding are present in person or by proxy.

FOURTEENTH. Shares hereunder shall be personal property, giving only the rights in this instrument, and in the certificates thereof, specifically set forth. The death of a shareholder during the continuance of this trust shall not operate to determine this trust, nor shall it entitle the representatives of the deceased shareholder to an accounting or to take any action in the courts or elsewhere against the Trustees; but the executors, administrators, or assigns of any deceased shareholder shall succeed to the rights of said decedent under this trust, upon the surrender of the certificate of shares owned by them.

The ownership of shares hereunder shall not entitle the shareholders to any title in or to the trust property whatsoever, or right to call for a partition or division of the same, or

for an accounting; and no shareholder shall have any other or further rights than the right of a stockholder in a corporation, so far as the same may be applicable.

FIFTEENTH. The Trustees shall have no power to bind the shareholders personally, or to call upon them for the payment of any sum of money or any assessment whatever other than such sums as they may at any time personally agree to pay by way of subscription to new shares or otherwise. All persons or corporations extending credit to, contracting with, or having any claim against the Trustees shall look only to the funds and property of the trust for the payment of any such contract or claim, or for the payment of any debt, damage, judgment, or decree, or of any money that may otherwise become due or payable to them from the Trustees, so that neither the Trustees, shareholders, nor officers, present or future, shall be personally liable therefor.

In every written order, contract, or obligation which the Trustees or officers shall give, authorize, or enter into, it shall be the duty of the Trustees and officers to stipulate, or cause to be stipulated, that neither the Trustees, officers, nor shareholders shall be held to any personal liability under or by reason of such order, contract or obligation.

It is further expressly agreed that in case any Trustee, officer, or shareholder shall at any time for any reason be held to or be under any personal liability as such Trustee, officer, or shareholder, not due to his acts in bad faith, then such Trustee, officer, or shareholder, shall be held harmless and indemnified out of the trust estate from and of all loss, cost, damage, or expense by reason of such liability; and, if at any time the trust estate shall be insufficient to provide for such indemnity and to satisfy all liabilities of and claims upon it, then the trust estate shall, in preference and priority over any and all other claims or liens whatsoever, except mortgages, and except as otherwise expressly provided by law, be applied first to the indemnification of the Trustees from any loss, cost, damage or expense in connection with any personal liability which they may be under or have incurred except as aforesaid; next, to the indemnification in the same manner of the officers, and thereafter to the indemnification in like manner of the shareholders.

SIXTEENTH. This trust shall continue for the term of twenty-one years after the death of the last survivor of the persons whose names are signed hereto, at which time the then Trustees shall proceed to wind up its affairs, liquidate its assets, and distribute the same among the holders of preferred and common shares: provided, however, that, if prior to the expiration of said period the holders of at least two-thirds of the shares then outstanding shall, at a meeting called for that purpose, vote to terminate or continue this trust, then said trust shall either forthwith terminate or continue in existence for such further period as may then be determined. For the purpose of winding up their affairs and liquidating this trust the then Trustees shall continue in office until such duties have been fully performed.

SEVENTEENTH. This Agreement and Declaration of Trust may be amended or altered in any particular whatsoever, except as regards the exemption from personal liability of the Trustees, officers, and shareholders, and except as regards the priorities of the preferred shares, at any annual or special meeting of the shareholders, with the consent of the holders of at least two-thirds of the shares of each class then outstanding, provided notice of the proposed amendment or alteration shall have been given in the call for the meeting: and in case of such alteration or amendment the same shall be attached to and made a part of this agreement, and a copy thereof, with a certificate of the Secretary as to its adoption, shall be filed with the Trust Company at that time having the custody of the duplicate original of this instrument.

Nothing in this article contained shall in any way be construed to limit the power to increase or reduce the number of shares as provided in the ninth article hereof.

EIGHTEENTH. A duplicate original of this Agreement and Declaration of Trust shall be deposited with such Trust Company in the City of Boston as the Trustees may from time to time designate, and the Trustees shall have power at any time to change the company with which such duplicate original is deposited.

NINETEENTH. The Trustees from time to time shall determine whether and to what extent and at what time, and

placed under what conditions and regulations the accounts and books of the Trustees or any of them shall be open to the inspection of the shareholders, and no shareholder shall have any right to inspect any account of book or document of the Trustees except as authorized by the Trustees or by resolution of the shareholders.

IN WITNESS WHEREOF, the said Charles Francis Adams, 2d, Walter Cabot Baylies, Samuel Carr, Robert Clarence Pruyn, Joseph Ballister Russell, Frederic Elmer Snow, Charles Augustus Stone, Albert Strauss, Christopher Minot Weld, and Robert Winsor, Trustees hereinbefore mentioned, have hereunto set their hands and seals in token of their acceptance of the trust hereinbefore mentioned, for themselves and their successors, and the said Francis H. Peabody, Frank G. Webster, Frank E. Peabody, and Robert Winsor, co-partners, carrying on business in the City of Boston under the name of Kidder, Peabody & Company, and James Seligman, Emil Carlebach, Albert Strauss and Frederick Strauss, co-partners, carrying on business in the City of New York, under the name of J. & W. Seligman & Company, have hereunto set their hand and seals in token of their assent to and approval of said terms of trust, for themselves and their assigns, the day and year first above written.

(The signatures and seals of the above mentioned persons which appear at this point in the original followed by a notarial seal are here omitted).

Sept. 25th, 1902.

We, the undersigned, Trustees under an Agreement and Declaration of Trust of the Massachusetts Gas Companies dated the 25th day of September, 1902, hereby acknowledge that we have received due notice of the meeting of said Trustees to be held at 115 Devonshire St., Boston, Mass., on the 25th day of September, 1902, at 10 o'clock A.M., for the purposes of organization, including the election of officers, adoption of by-laws and transaction of business incidental thereto, for the purpose of considering and acting upon a proposition from Kidder, Peabody & Company and J. & W. Seligman & Company relative to the transfer to the Massachusetts Gas Companies of certain properties and cash as mentioned in the Declaration of Trust of said Massa-

achusetts Gas Companies, and taking such action as may be necessary to carry the same into effect if the offer contained in said proposition is accepted; and we hereby consent and agree that said meeting shall be held at the time and place above mentioned for the purpose above stated.

(Signed)

CHARLES FRANCIS ADAMS, 2nd.
WALTER CABOT BAYLIES
ROBERT CLARENCE PRUYN
JOSEPH BALLISTER RUSSELL
FREDERIC ELMER SNOW
CHARLES AUGUSTUS STONE
ALBERT STRAUSS
CHRISTOPHER MINOT WELD
ROBERT WINSOR.
SAMUEL CARR.

The stationery of the Massachusetts Gas Companies has printed in red ink in the upper right hand corner, the following:

"The name 'Massachusetts Gas Companies' is the designation of the Trustees for the time being under an agreement and declaration of Trust, dated 1902, and all persons dealing with the Massachusetts Gas Companies must look solely to the Trust property for the enforcement of any claim against the Companies, as neither the Trustees, Officers nor Shareholders assume any personal liability for obligations entered into on behalf of the Companies.

C. FORMS PERTAINING TO COMBINATION ORGANIZATIONS

FORM 57

FACTOR'S AGREEMENT

NATIONAL WALL PAPER COMPANY¹

Memorandum of agreement between of
(called the purchaser) and the National Wall Paper Company
of New York, N. Y., (called the company).

¹ Op. cit. N. Y. Trust Investigation, 1897, pp. 804-806.

1. The purchaser agrees to select and order from and out of jobbing lines of the machine made goods of the company on or before October 1, 1896, wall paper to the aggregate amount of \$....., which hereby request the company to manufacture for prior to April 1, 1897, goods to be delivered F. O. B. at New York, or at the respective places of manufacture.

2. The terms of this sale are four (4) months from date of invoice, with a discount at the rate of one per cent per month for anticipated payments. Goods shipped between October 15th and March 1st to date from March 1st, and orders for goods not shipped before March 1, 1897, may be cancelled by either party to this agreement.

3. The purchasers expressly guarantee and agree that between September 1, 1896, and June 30, 1897, will not purchase or acquire any wall paper or hangings the product of any person or corporation other than the company, and that will give additional and duplicate orders prior to July 1, 1897, to the amount of \$....., and in consideration of such guarantee and upon the performance thereof company shall credit the purchaser with the discounts hereinafter named on the attached schedule on all purchases from the jobbing lines of the machine made goods of the company between said dates.² Such discounts shall be figured and credited upon the basis of the shipments made hereunder and the discounts shall be calculated upon the gross prices published by the company in its price list for the patterns selected by the purchaser. The purchasers guarantee as a condition of the allowance of such discounts to refrain from making such use thereof among the trade as to interfere with the uniformity of the company's price and terms, and that (the purchaser) will at all times during this contract maintain the company's road prices.

4. The company agrees to extend the same line of discounts referred to above to such goods as are contained in the exclusive lines of the machine made goods of the company, on the express guarantee that such goods will be used only for the retail department of the purchaser in the City of....., and will not be offered at wholesale within his store or on the road.

² This sentence is thus in original.—Ed.

This contract shall at all times and for every purpose be deemed to have been made and executed at the principal office of the company, in the City of New York, and it shall for every purpose be construed under the laws of the State of New York.

Dated, the city of New York.....1896.

.....
National Wall Paper Company,
President.

FORM 58

A TYPICAL POOL AGREEMENT

THE STEEL RAIL POOL¹

Memorandum of agreement, entered into August 2, 1887, by and between the North Chicago Rolling Mill Company, the Cambria Iron Company, the Pennsylvania Steel Company, the Union Steel Company, the Lackawanna Iron and Coal Company, the Joliet Steel Company, the Western Steel Company, the Cleveland Rolling Mill Company, Carnegie Brothers & Co., Limited; Carnegie, Phipps & Co., Limited; the Bethlehem Iron Company, the Scranton Steel Company, the Troy Steel & Iron Company, the Worcester Steel Works and the Springfield Iron Company.

We, the before-named companies and corporations, manufacturers of steel rails, hereby mutually agree one with the other, that we will restrict our sales and the product of the steel rails of 50 pounds to the yard and upward, applying to orders taken by us and to be delivered by us or from our respective works during the year 1888, as hereinafter allotted and limited; and we respectively bind ourselves not to sell in excess of our current allotments, without first obtaining the consent of the Board of Control thereto — that is to say:

It is agreed, there shall now be made an allotment of 800,000 tons of rails, which shall be divided and apportioned to and among the several parties hereto to be sold by them during the year 1888, under the following basis of percentages, to wit; North

¹ Report of the Commissioner of Corporations on the Steel Industry. Part 1, pp. 69-71.

Chicago Rolling Mill Company, 12 1/2 per cent; Pennsylvania Steel Company, 9 8/10 per cent; Bethlehem Iron Company, 9 per cent; Carnegie Bros. & Co., Limited, and Carnegie, Phipps & Co., Limited (jointly), 13 5/10 per cent; Joliet Steel Company, 8 per cent; Lackawanna Iron and Coal Company, 9 per cent; Cambria Iron Company 8 per cent; Scranton Steel Company, 8 per cent; the Union Steel Company, 8 per cent; Cleveland Rolling Mill Company, 4 8/10 per cent; Troy Steel & Iron Company, 4 5/10 per cent; Western Steel Company, 4 5/10 per cent; Worcester Steel Works, 1 4/10 per cent.

And in addition to the said allotment of 800,000 tons of rails above allotted, an additional allotment of 250,000 tons is hereby made and allotted to the Board of Control, to be reallocated and reapportioned by it, as, and to whom, it may deem equitable, in the adjustment of any differences that may arise. It being also further agreed that all subsequent allotments of rails hereafter made, to be sold under this agreement during the year 1888, shall also be divided and apportioned to the several parties hereto in the same ratio of percentages as said apportionment of 800,000 tons is herein divided and apportioned.

It is further agreed, that the Board of Control shall, from time to time, make such further allotments as shall be necessary to at all times keep the unsold allotments at least 200,000 tons in excess of the total current sales, as shown by the monthly reports of sales. This is to be in addition to the then unappropriated part of the 250,000 tons herein before allotted to the Board of Control to adjust differences.

It is further agreed, on the first day of April, July and October, the Board of Control are authorized and directed to cancel such part of the unmade allotments of the respective parties hereto as they, the said Board of Control, shall determine such party unable to make in due time, and all allotments so canceled the Board of Control shall have the right to reallocate to any of the other parties hereto; it being understood that all such cancellations shall apply only to allotments standing to the credit of the respective parties hereto on the dates above named, but no reallocation as aforesaid shall be made by the Board of Control to any of the parties hereto for the purpose of enabling them or any of them, to make and sell rails from foreign made blooms.

It is further agreed, that all transfers of parts of allotments from one party to another shall be made by the Board of Control.

It is further agreed, that there shall be a Board of Control, consisting of three members, namely Orrin W. Potter, Luther S. Bent and W. W. Thurston, who shall have power to employ a paid secretary and treasurer.

It is further agreed, that the Board of Control, upon the written consent of 75 per cent of the percentages as hereinbefore named, shall increase the allotments for the year 1888, and such increase shall be allotted to the parties hereto as hereinbefore provided.

It is further agreed, that each party whose name is hereunto annexed, shall and will make monthly returns to the Board of Control of all contracts for delivery of rails of 50 pounds to the yard and upward during the year 1888, and also of all shipments of such rails made by them during said year; a copy of such return shall be furnished to each party hereto.

It is further agreed, that all the parties hereto shall and will, on or before January 15, 1888, make a written return to the Board of Control of all the rails of 50 pounds to the yard and upward (designating the weight) which they respectively had on hand January 1, 1888, stating whether the same are sold, and if sold on what order they apply.

It is further agreed; that the Board of Control shall have the right whenever they deem it expedient to convene a meeting of the parties hereto, and they shall give at least ten days' previous notice of all meetings, and any business transacted at such meetings, and receiving 75 per cent of the votes present thereat, either in person or by proxy, shall be binding on all the parties hereto, excepting as to a change in percentages as aforesaid:

The Board of Control shall be required to call a meeting of the parties hereto when requested so to do in writing, signed by any three of the contracting parties, but such request and such notice shall state the object for which such meeting is called.

It shall be the duty of the Board of Control to have a proper record kept of all the returns made to it, with power from time to time to change the form of return as they may deem expedient.

The Board of Control shall have authority to levy an assess-

ment, pro rata to the allotted tonnage, to defray the actual expenses made necessary to carry out this agreement.

It is further agreed, that we will, respectively, immediately make return to the Board of Control of all rails of 50 pounds to the yard and upward which we are now under contract to deliver during the year 1888, said return to state to whom such rails are sold and when they are to be delivered.

(Signatures)

FORM 59

STANDARD OIL TRUST AGREEMENT AND SUPPLEMENTAL TRUST AGREEMENT OF 1882¹

This agreement, made and entered upon this second day of January, A.D. 1882, by and between all the persons who shall now or may hereafter execute the same as parties thereto, witnesseth:

I. It is intended that the parties to this agreement shall embrace three classes, to wit:

(1) All the stockholders and members of the following corporations and limited partnerships, to wit:

Acme Oil Co. (New York), Acme Oil Co. (Pennsylvania), Atlantic Refining Co., of Phila.; Bush & Co., Limited, Camden Consolidated Oil Co., Elizabethport Acid Works, Imperial Refining Co., Limited, Chas. Pratt & Co., Paine, Ablett & Co., Limited, Standard Oil Co. (Ohio), Standard Oil Co. (Pittsburgh), Smith's Ferry Oil Trans. Co., Solar Oil Co., Limited, Sone & Fleming Mfg. Co., Limited.

Also all the stockholders and members of such other corporations and limited partnerships as may hereafter join in this agreement at the request of the trustees herein provided for.

(2) The following individuals, to wit:

W. C. Andrews, John D. Archbold, Lide K. Arter, J. A. Bostwick, Benj. Brewster, D. Bushnell, Thomas C. Bushnell, J. N. Camden, Henry L. Davis, H. M. Flagler, Mrs. H. M. Flagler, H. M. Hanna, and George W. Chapin, D. M. Harkness,

¹ Appendix. Report of Industrial Commission, Vol. 1, pp. 1221-26.

D. M. Harkness, trustee; S. V. Harkness, John Huntington, H. A. Hutchins, Chas. F. G. Heye, O. B. Jennings, Chas. Lockhart, A. M. McGregor, Wm. M. Macy, Wm. H. Macy, Jr., estate of Josiah Macy, Jr., Wm. H. Macy, Jr., executor; O. H. Payne, O. H. Payne, trustee; Chas. Pratt, Horace A. Pratt, C. M. Pratt, A. J. Pouch, John D. Rockefeller, Wm. Rockefeller, Henry H. Rogers, W. P. Thompson, J. J. Vandergrift, Wm. T. Wardwall, W. G. Warden, Josiah L. Warden; Warden, Frew & Co., Louise C. Wheaton, Julia H. York, George H. Vilas, M. R. Keith, Geo. F. Chester, trustees.

Also all such individuals as may hereafter join in this agreement at the request of the trustees herein provided for.

(3) A portion of the stockholders and members of the following corporations and limited partnerships, to wit:

American Lubricating Oil Co., Baltimore United Oil Co., Beacon Oil Co., Bush & Denslow Manuf'g Co., Central Refining Co., of Pittsburgh; Chesbrough Manuf'g Co., Chess-Carley Co., Consolidated Tank Line Co., Inland Oil Co., Keystone Refining Co., Maverick Oil Co., National Transit Co., Portland Kerosene Oil Co., Producers' Con'd Land and Petroleum Co., Signal Oil Works, Limited, Thompson and Bedford Co., Limited, Devoe Manuf'g Co., Eclipse Lubricating Oil Co., Limited, Empire Refining Co., Limited, Franklin Pipe Co., Limited, Galena Oil Works, Limited, Galena Farm Oil Co., Limited, Germania Mining Co., Vacuum Oil Co., H. C. Van Tine & Co., Limited, Waters-Pierce Oil Co.

Also stockholders and members (not being all thereof) of other corporations and limited partnerships who may hereafter join in this agreement at the request of the trustees herein provided for.

II. The parties hereto do covenant and agree to and with each other, each in consideration of the mutual covenants and agreements of the others, as follows:

(1) As soon as practicable a corporation shall be formed in each of the following States, under the laws thereof, to wit: Ohio, New York, Pennsylvania and New Jersey; Provided, however, that instead of organizing a new corporation, any existing charter and organization may be used for the purpose when it can advantageously be done.

(2) The purposes and powers of said corporations shall be to mine for, produce, manufacture, refine, and deal in petroleum and all its products, and all the materials used in such business, and transact other business collateral thereto. But other purposes and powers shall be embraced in the several charters such as shall seem expedient to the parties procuring the charter, or, if necessary to comply with the law, the powers aforesaid may be restricted and reduced.

(3) At any time hereafter, when it may seem advisable to the trustees herein provided for, similar corporations may be formed in other States and Territories.

(4) Each of said corporations shall be known as the Standard Oil Co. of.....(and here shall follow the name of the State or Territory by virtue of the laws of which said corporation is organized).

(5) The capital stock of each of said corporations shall be fixed at such an amount as may seem necessary and advisable to the parties organizing the same, in view of the purpose to be accomplished.

(6) The shares of stock of each of said corporations shall be issued only for money, property, or assets equal at a fair valuation to the par value of the stock delivered therefor.

(7) All of the property, real and personal, assets, and business of each and all of the corporations and limited partnerships mentioned or embraced in class (1) shall be transferred to and vested in the said several Standard Oil companies. All of the property, assets, and business in or of each particular State shall be transferred, to and vested in the Standard Oil Co. of that particular State, and in order to accomplish such purposes the directors and managers of each and all of the several corporations and limited partnerships mentioned in class first are hereby authorized and directed by the stockholders and members thereof (all of them being parties to this agreement) to sell, assign, transfer, convey, and make over, for the consideration hereinafter mentioned, to the Standard Oil Co., or companies of the proper State or States, as soon as said corporations are organized and ready to receive the same, all the property, real and personal, assets, and business of said corporations and limited partnerships.

Correct schedules of such property, assets, and business shall accompany each transfer.

(8) The individuals embraced in class second of this agreement do each for himself agree, for the consideration hereinafter mentioned, to sell, assign, transfer, convey, and set over all the property, real and personal, assets, and business mentioned and embraced in schedules accompanying such sale and transfer to the Standard Oil Company or Companies of the proper State or States, as soon as the said corporations are organized and ready to receive the same.

(9) The parties embraced in class third of this agreement do covenant and agree to assign and transfer all of the stock held by them in the corporations or limited partnerships herein named, to the trustees herein provided for, for the consideration and upon the terms hereinafter set forth. It is understood and agreed that the said trustees and their successors may hereafter take the assignment of stocks in the same or similar companies upon the terms herein provided, and that whenever and as often as all the stocks of any corporation and limited partnership are vested in said trustees the proper steps may then be taken to have all the money, property, real and personal, of said corporation or partnership assigned and conveyed to the Standard Oil Company of the proper State on the terms and in the mode herein set forth, in which event the trustees shall receive stocks of the Standard Oil Company equal to the value of the money, property, and business assigned, to be held in place of the stocks of the company or companies assigning such property.

(10) The consideration for the transfer and conveyance of the money, property, and business aforesaid to each of any of the Standard Oil Companies shall be stock of the respective Standard Oil Company to which said transfer or conveyance is made, equal at par value to the appraised value of the money, property, and business so transferred. Said stock shall be delivered to the trustees hereinafter provided for, and their successors, and no stock of any of said companies shall ever be issued except for money, property, or business equal at least to the par value of the stock so issued, nor shall any stock be issued by any of said companies for any purpose except to the trustees herein

provided for, to be held subject to the trusts hereinafter specified. It is understood, however, that this provision is not intended to restrict the purchase, sale, and exchange of property of said Standard Oil Companies as fully as they may be authorized to do by their respective charters, provided only that no stock be issued therefor except to said trustees.

(11) The consideration for any stock delivered to said trustees as above provided for, as well as for stocks delivered to said trustees by persons mentioned or included in class third of this agreement, shall be the delivery by said trustees, to the persons entitled thereto, of trust certificates hereinafter provided for, equal at par value to the par value of the stocks of the said Standard Oil companies so received by said trustees, and equal to the appraised value of the stocks of other companies or partnerships delivered to said trustees. (The said appraised value shall be determined in a manner agreed upon by the parties in interest and said trustees). It is understood and agreed, however, that the said trustees may, with any trust funds in their hands, in addition to the mode above provided, purchase the bonds and stocks of other companies engaged in business similar or collateral to the business of said Standard Oil companies, on such terms and in such mode as they may deem advisable, and shall hold the same for the benefit of the owners of said trust certificates, and may sell, assign, transfer, and pledge such bonds and stocks whenever they may deem it advantageous to said trust so to do.

III. The trusts upon which said stocks shall be held, and the number, powers, and duties of said trustees, shall be as follows:

(1) The number of trustees shall be nine.

(2) J. D. Rockefeller, O. H. Payne, and Wm. Rockefeller are hereby appointed trustees, to hold their office until the first Wednesday of April, A.D. 1885.

(3) J. A. Bostwick, H. M. Flagler, and W. G. Warden are hereby appointed trustees, to hold their office until the first Wednesday of April, A.D. 1884.

(4) Chas. Pratt, Benj. Brewster, and John D. Archbold, are hereby appointed trustees, to hold office until the first Wednesday of April, A.D. 1883.

(5) Elections for trustees to succeed those herein appointed shall be held annually, at which election a sufficient number of trustees shall be elected to fill all vacancies occurring either from expiration of the term of office of trustees or from any other cause. All trustees shall be elected to hold their office for three years, except those elected to fill a vacancy arising from any cause except expiration of term, who shall be elected for the balance of the term of the trustee whose place they are elected to fill. Every trustee shall hold his office until his successor is elected.

(6) Trustees shall be elected by ballot by the owners of trust certificates or their proxies. At all meetings the owners of trust certificates who may be registered as such on the books of the trustees may vote in person or by proxy, and shall have one vote for each and every share of trust certificates standing in their names; but no such owner shall be entitled to vote upon any share which has not stood in his name thirty days prior to the day appointed for the election. The transfer books may be closed for thirty days immediately preceding the annual election. A majority of the shares represented at such election shall elect.

(7) The annual meeting of the owners of said trust certificates for the election of trustees and for other business shall be held at the office of the trustees in the city of New York on the first Wednesday of April of each year, unless the place of meeting be changed by the trustees, and said meeting may be adjourned from day to day until its business is completed. Special meetings of the owners of said trust certificates may be called by the majority of the trustees at such times and places as they may appoint. It shall also be the duty of the trustees to call a special meeting of holders of trust certificates whenever requested to do so by a petition signed by the holders of 10 per cent in value of such certificates. The business of such special meetings shall be confined to the object specified in the notice given therefor. Notice of the time and place of all meetings of the owners of trust certificates shall be given by personal notice as far as possible and by public notice in one of the principal newspapers in each State in which a Standard Oil Co. exists at least ten days before such meeting. At any meeting a majority in the value of

the holders of trust certificates represented consenting thereto, by-laws may be made, amended, or repealed relative to the mode of election of trustees and other business of the holders of trust certificates; provided, however, that said by-laws shall be in conformity with this agreement. By-laws may also be made, amended, and repealed at any meeting, by and with the consent of a majority in value of the holders of trust certificates, which alter this agreement relative to the number, powers, and duties of the trustees and to other matters tending to the more efficient accomplishment of the objects for which the trust is created, provided only that the essential intents and purposes of this agreement be not thereby changed.

(8) Whenever a vacancy occurs in the board of trustees more than sixty days prior to the annual meeting for the election of trustees, it shall be the duty of the remaining trustees to call a meeting of the owners of the Standard Oil Trust certificates for the purpose of electing a trustee or trustees to fill the vacancy or vacancies. If any vacancy occurs in the board of trustees, from any cause, within sixty days of the date of the annual meeting for the election of trustees, the vacancy may be filled by a majority of the remaining trustees, or, at their option, may remain vacant until the annual election.

(9) If, for any reason, at any time, a trustee or trustees shall be appointed by any court to fill any vacancy or vacancies in said board of trustees, the trustee or trustees so appointed shall hold his or their respective office or offices only until a successor or successors shall be elected in the manner above provided for.

(10) Whenever any change shall occur in the board of trustees, the legal title to the stock and other property held in trust shall pass to and vest in the successors of said trustees without formal transfer thereof; but if any time such formal transfer shall be deemed necessary or advisable it shall be the duty of the board of trustees to obtain the same, and it shall be the duty of any retiring trustee, or the administrator or executor of any deceased trustee, to make said transfer.

(11) The trustees shall prepare certificates which shall show the interest of each beneficiary in said trust, and deliver them

to the persons properly entitled thereto. They shall be divided into shares of the par value of \$100 each, and shall be known as "Standard Oil Trust certificates," and shall be issued subject to all the terms and conditions of this agreement. The trustees shall have power to agree upon and direct the form and contents of said certificates, and the mode in which they shall be signed, attested and transferred. The certificates shall contain an express stipulation that the holders thereof shall be bound by the terms of this agreement, and by the by-laws herein provided for.

(12) No certificates shall be issued except for stocks and bonds held in trust, as herein provided for, and the par value of certificates issued by said trustees shall be equal to the par value of the stocks of said Standard Oil Companies, and the appraised value of other bonds and stocks held in trust. The various bonds, stocks, and moneys held under said trust shall be held for all parties in interest jointly, and the trust certificates so issued shall be the evidence of the interest held by the several parties in this trust. No duplicate certificates shall be issued by the trustees except upon the surrender of the original certificate or certificates for cancellation, or upon satisfactory proof of the loss thereof, and in the latter case they shall require a sufficient bond of indemnity.

(13) The stocks of the various Standard Oil Companies held in trust by said trustees shall not be sold, assigned, or transferred by said trustees, or by the beneficiaries, or by both combined, so long as the trust endures. The stocks and bonds of other corporations held by said trustees may be by them exchanged or sold and the proceeds thereof distributed pro rata to the holders of trust certificates, or said proceeds may be held and re-invested by said trustees for the purposes and uses of the trust; provided, however, that said trustees may from time to time assign such shares of stock of said Standard Oil Companies as may be necessary to qualify any person or persons chosen or to be chosen as directors and officers of any of said Standard Oil Companies.

(14) It shall be the duty of said trustees to receive and safely to keep all interest and dividends declared and paid upon any of

the said bonds, stocks, and moneys held by them in trust, and to distribute all moneys received from such sources or from sales of trust property or otherwise by declaring and paying dividends upon the Standard Trust certificates as funds accumulate, which in their judgment are not needed for the uses and expenses of said trust. The trustees shall, however, keep separate accounts and receipts from interest and dividends, and of receipts from sales or transfers of trust property, and in making any distribution of trust funds, in which moneys derived from sales or transfers shall be included, shall render the holders of trust certificates a statement showing what amount of the fund distributed has been derived from such sales or transfers. The said trustees may be also authorized and empowered by a vote of a majority in value of holders of trust certificates, whenever stocks or bonds have accumulated in their hands from money purchases thereof, or the stocks and bonds held by them have increased in value, or stock dividends shall have been declared by any of the companies whose stocks are held by said trustees, or whenever from any such cause it is deemed advisable so to do, to increase the amount of trust certificates to the extent of such increase or accumulation of values and to divide the same among the persons then owning trust certificates pro rata.

(15) It shall be the duty of said trustees to exercise general supervision over the affairs of said several Standard Oil Companies, and as far as practicable over the other companies or partnerships, any portion of whose stock is held in said trust. It shall be their duty as stockholders of said companies to elect as directors and officers thereof faithful and competent men. They may elect themselves to such positions when they see fit so to do, and shall endeavor to have the affairs of said companies managed and directed in the manner they may deem most conducive to the best interests of the holders of said trust certificates.

(16) All the powers of the trustees may be exercised by a majority of their number. They may appoint from their own number an executive and other committees. A majority of each committee shall exercise all the powers which the trustees may confer upon such committee.

(17) The trustees may employ and pay all such agents and

attorneys as they may deem necessary in the management of said trust.

(18) Each trustee shall be entitled to a salary for his services not exceeding twenty-five thousand dollars per annum, except the president of the board, who may be voted a salary not exceeding thirty thousand dollars per annum, which salaries shall be fixed by said board of trustees. All salaries and expenses connected with or growing out of the trust shall be paid by the trustees from the trust fund.

(19) The board of trustees shall have its principal office in the city of New York, unless changed by vote of the trustees, at which office, or in some place of safe deposit in said city, the bonds and stocks shall be kept. The trustees shall have power to adopt rules and regulations pertaining to the meetings of the board, the election of officers, and the management of the trust.

(20) The trustees shall render at each annual meeting a statement of the affairs of the trust. If a termination of the trust be agreed upon, as hereinafter provided, or within a reasonable time prior to its termination by lapse of time, the trustees shall furnish to the holders of the trust certificates a true and perfect inventory and appraisement of all stocks and other property held in trust, and a statement of the financial affairs of the various companies whose stocks are held in trust.

(21) The trust shall continue during the lives of the survivors and survivor of the trustees in this agreement named, and for twenty-one years thereafter; provided, however, that if at any time after the expiration of ten years two-thirds of all the holders in value, or if after the expiration of one year 90 per cent of all the holders in value of trust certificates shall, at a meeting of holders of trust certificates called for that purpose, vote to terminate this trust at some time to be by them then and there fixed, the said trust shall terminate at the date so fixed. If the holders of trust certificates shall vote to terminate the trust as aforesaid, they may, at the same meeting, or at a subsequent meeting called for that purpose, decide by vote of two-thirds in value of their number the mode in which the affairs of the trust shall be wound up, and whether the trust property shall be

distributed or whether part, and if so, what part shall be divided and what part sold, and whether such sales shall be public or private. The trustees, who shall continue to hold their office for that purpose, shall make the distribution in the mode directed, or, if no mode be agreed upon, by two-thirds in value as aforesaid, the trustees shall make distribution of the trust property according to law. But said distribution, however made, and whether it be of property, or values, or of both shall be just and equitable, and such as to insure to each owner of a trust certificate his due proportion of the trust property of the value thereof.

(22) If the trust shall be terminated by the expiration of the time for which it is created, the distribution of the trust property shall be directed and made in the mode above provided.

(23) This agreement, together with the registry of certificates, book of accounts, and other books and papers connected with the business of said trust, shall be safely kept at the principal office of said trustees.

(Signatures).

SUPPLEMENTAL AGREEMENT

WHEREAS in and by agreement dated January 2, 1882, and known as the Standard Trust agreement, the parties thereto did mutually covenant and agree, inter alia, as follows, to wit: That corporations to be known as Standard Oil Companies of various States should be formed, and that all of the property, real and personal assets, and business of each and all of the corporations and limited partnerships mentioned or embraced in class first of said agreement should be transferred and vested in the said several Standard Oil Companies; that all of the property, assets, and business in or of each particular State should be transferred to and vested in the Standard Oil Company of that particular State, and the directors and managers of each and all of the several corporations and associations mentioned in class first were authorized and directed to sell, assign, transfer, and convey, and to make over to the Standard Oil Company or Companies of the proper State or States, as soon as said corporations were organized and ready to receive the same, all of the property, real and personal, assets and business of said corporations or

associations; and whereas it is not deemed expedient that all of the companies and associations mentioned should transfer their property to the said Standard Oil Companies at the present time, and in case of some companies and associations it may never be deemed expedient that the said transfer should be made, and said companies and associations go out of existence; and whereas it is deemed advisable that a discretionary power should be vested in the trustees as to when such transfer or transfers should take place, if at all: Now, it is hereby mutually agreed between the parties to the said trust agreement, and as supplementary thereto, that the trustees named in the said agreement and their successors shall have the power and authority to decide what companies shall convey their property as in said agreement contemplated, and when the said sales and transfers shall take place, if at all, and until said trustees shall so decide, each of said companies shall remain in existence, and retain its property and business, and the trustees shall hold the stocks thereof in trust, as in said agreement provided. In the exercise of said discretion the trustees shall act by a majority of their number as provided in said trust agreement. All portions of said trust agreement relating to this subject shall be considered so changed as to be in harmony with this supplemental agreement.

In witness whereof, the said parties have subscribed this agreement this 4th day of January, 1882.

(Duly signed by the same parties).

FORM 60

DIRECTORS' RESOLUTION FOR CONSOLIDATION¹

Whereas, It is the sense of this board that the consolidation of the A. Company, the B. Company and the C. Company to form a single corporation, and the consolidation and amalgamation of their respective capital stocks, properties and franchises will be mutually advantageous, and

Whereas, The holders of more than three-fourths in value of all the capital stock of each of said companies have consented in

¹ From Wood, *Modern Business Corporations*.

writing to a consolidation of the said A. Company, B. Company and C. Company upon the terms following, to wit:

First. That said consolidation shall take place at once, and the consolidated corporation shall continue in existence for fifty years.

Second. That the consolidated corporation shall bear the name of the A. Company.

Third. That the consolidated corporation shall take over and become the owner of all the lands, properties, franchises and assets of every description belonging to each of said constituent companies; shall assume, become liable for, pay and discharge, all valid debts, liabilities and obligations of every kind, character and description, heretofore incurred or entered into by either and all of said constituent companies; shall hold said property and franchises subject to all the valid conditions, liens and claims to which the same were and are subject in the hands of the several constituent companies; and shall assume, undertake and perform all contracts, agreements and undertakings to which any and all of said constituent companies are lawfully bound to the same extent in like manner as such constituent company or companies are bound to keep and perform the same.

Fourth. That the objects and purposes of the consolidated company shall be made to embrace the objects and purposes of all the three constituent corporations.

Fifth. That the consolidated company shall have a board of directors equal in number to the combined boards of the three constituent companies, and its directors for the first year shall be all the directors of all of said companies.

Sixth. That its principal place of business shall be that of the A. Company.

Seventh. That the capital stock of said consolidated company shall consist of one hundred thousand (100,000) shares of one hundred dollars (\$100) each, and shall be issued to shareholders in the constituent companies (upon surrender of their shares of stock therein) in the proportion that such shares held by them respectively shall bear to the combined capital stocks of all the said constituent companies.

Be it resolved, that the propositions and conditions above recited are hereby accepted and adopted by the board of directors of the Company.

FORM 61

STOCKHOLDERS' RESOLUTION AUTHORIZING
CONSOLIDATION

Whereas, A consolidation of the A. Company, the B. Company and the C. Company under the name of the A Company, has been proposed on terms and conditions set forth in an agreement entered into on the day of, 19...., between the Directors of said corporations and heretofore submitted to the stockholders of this Company; and

Whereas, Said proposed consolidation meets with the approval of the stockholders of this Corporation:

Now, Therefore, Be It Resolved, That the Board of Directors of this Company be and hereby is fully authorized, empowered, and instructed to take all such steps as may be necessary or desirable to carry said consolidation into effect in accordance with the terms of said agreement between the Directors of the three aforementioned corporations.

FORM 62

CHARTER OF AN INDUSTRIAL CONTROL COMPANY
AMENDED CERTIFICATE OF INCORPORATION
OF UNITED STATES STEEL CORPORATION

We, the undersigned, in order to form a corporation for the purposes hereinafter stated, under and pursuant to the provisions of the Act of the Legislature of the State of New Jersey, entitled "An Act concerning corporations (Revision of 1896)," and the acts amendatory thereof and supplemental thereto, do hereby certify as follows:

I. The name of the corporation is

UNITED STATES STEEL CORPORATION

II. The location of its principal office in the State of New Jersey is at No. 51 Newark Street, in the City of Hoboken,

County of Hudson. The name of the agent therein and in charge thereof, upon whom process against the corporation may be served, is Hudson Trust Company. Said office is to be the registered office of said corporation.

III. The objects for which the corporation is formed are:

To manufacture iron, steel, manganese, coke, copper, lumber and other materials, and all or any articles consisting, or partly consisting, of iron, steel, copper, wood or other materials, and all or any products thereof.

To acquire, own, lease, occupy, use or develop any lands containing coal or iron, manganese, stone or other ores, or oil, and any wood lands, or other lands for any purpose of the Company.

To mine, or otherwise to extract or remove, coal, ores, stone, and other minerals and timber from any lands owned, acquired, leased, or occupied by the Company, or from any other lands.

To buy and sell, or otherwise to deal or to traffic in, iron, steel, manganese, copper, stone, ores, coal, coke, wood, lumber and other materials, and any of the products thereof, and any articles consisting, or partly consisting thereof.

To construct bridges, buildings, machinery, ships, boats, engines, cars and other equipment, railroads, docks, slips, elevators, water works, gas works and electric works, viaducts, aqueducts, canals and other water-ways, and any other means of transportation, and to sell the same, or otherwise to dispose thereof, or to maintain and operate the same, except that the Company shall not maintain or operate any railroad or canal in the State of New Jersey.

To apply for, obtain, register, purchase, lease, or otherwise to acquire, and to hold, use, own, operate and introduce, and to sell, assign, or otherwise to dispose of, any trade-marks, trade-names, patents, inventions, improvements and processes used in connection with, or secured under letters patent of the United States, or elsewhere, or otherwise; and to use, exercise, develop, grant licenses in respect of, or otherwise to turn to account any such trade-marks, patents, licenses, processes, and the like, or any such property or rights.

To engage in any other manufacturing, mining, construction or transportation business of any kind or character whatsoever,

and to that end to acquire, hold, own and dispose of any and all property, assets, stocks, bonds and rights of any and every kind; but not to engage in any business hereunder which shall require the exercise of the right of eminent domain within the State of New Jersey.

To acquire by purchase, subscription or otherwise, and to hold or to dispose of, stocks, bonds or any other obligations of any corporation formed for, or then or theretofore engaged in or pursuing, any one or more of the kinds of business, purposes, objects or operations above indicated, or owning or holding any property of any kind herein mentioned; or of any corporation owning or holding the stocks or the obligations of any such corporation.

To hold for investment, or otherwise to use, sell or dispose of, any stock, bonds, or other obligations of any such other corporation; to aid in any manner any corporation whose stock, bonds or other obligations are held or are in any manner guaranteed by the Company, and to do any other acts or things for the preservation, protection, improvement or enhancement of the value of any such stock, bonds or other obligations, or to do any acts or things designated for any such purpose; and, while owner of any such stock, bonds or other obligation, to exercise all the rights, powers and privileges of ownership thereof, and to exercise any and all voting power thereon.

The business or purpose of the Company is from time to time to do any one or more of the acts and things herein set forth; and it may conduct its business in other States and in the Territories and in foreign countries, and may have one office or more than one office, and keep the books of the Company outside of the State of New Jersey, except as otherwise may be provided by law; and may hold, purchase, mortgage and convey real and personal property either in or out of the State of New Jersey.

Without in any particular limiting any of the objects and powers of the corporation, it is hereby expressly declared and provided that the corporation shall have power to issue bonds and other obligations, in payment for property purchased or acquired by it, or for any object in or about its business; to

mortgage or pledge any stocks, bonds or other obligations, or any property which may be acquired by it, to secure any bonds or other obligations by it issued or incurred; to guarantee any dividends or bonds or contracts or other obligations; to make and perform contracts of any kind and description; and in carrying on its business, or for the purpose of attaining or furthering any of its objects, to do any and all other acts and things, and to exercise any and all other powers which a copartnership or natural person could do and exercise, and which now or hereafter may be authorized by law.

IV. The total authorized capital stock of the corporation is eleven hundred million dollars (\$1,100,000,000), divided into eleven million shares of the par value of one hundred dollars each. Of such total authorized capital stock, five million five hundred thousand shares, amounting to five hundred and fifty million dollars, shall be preferred stock, and five million five hundred thousand shares, amounting to five hundred and fifty million dollars, shall be common stock.

From time to time, the preferred stock and the common stock may be increased according to law, and may be issued in such amounts and proportions as shall be determined by the board of directors, and as may be permitted by law.

The holders of the preferred stock shall be entitled to receive when and as declared, from the surplus or net profits of the corporation, yearly dividends at the rate of seven per centum per annum, and no more, payable quarterly on dates to be fixed by the by-laws. The dividends on the preferred stock shall be cumulative, and shall be payable before any dividend on the common stock shall be paid or set apart: so that, if any year dividends amounting to seven per cent shall not have been paid thereon, the deficiency shall be payable before any dividends shall be paid upon or set apart for the common stock.

Whenever all cumulative dividends on the preferred stock for all previous years shall have been declared and shall have become payable, and the accrued quarterly instalments for the current year shall have been declared, and the company shall have paid such cumulative dividends for previous years and such accrued quarterly instalments, or shall have set aside from

its surplus or net profits a sum sufficient for the payment thereof, the Board of Directors may declare dividends on the common stock, payable then or thereafter, out of any remaining surplus or net profits.

In the event of any liquidation or dissolution or winding up (whether voluntary or involuntary) of the corporation, the holders of the preferred stock shall be entitled to be paid in full both the par amount of their shares, and the unpaid dividends accrued thereon before any amount shall be paid to the holders of the common stock; and after the payment to the holders of the preferred stock of its par value, and the unpaid accrued dividends thereon, the remaining assets and funds shall be divided and paid to the holders of the common stock according to their respective shares.

V. The names and post-office addresses of the incorporators, and the number of shares of stock for which severally and respectively we do hereby subscribe (the aggregate of our said subscriptions, being three thousand dollars, is the amount of capital stock with which the corporation will commence business, are as follows:

Name	Post office address	Number of Shares	
		Preferred stock	Common stock
Charles C. Cluff	51 Newark Street, Hoboken, New Jersey	5	5
William J. Curtis	Ditto	5	5
Charles MacVeagh	Ditto	5	5

VI. The duration of the corporation shall be perpetual.

VII. The number of directors of the Company shall be fixed from time to time by the by-laws; but the number if fixed at more than three, shall be some multiple of three. The directors shall be classified with respect to the time for which they shall severally hold office by dividing them into three classes, each consisting of one-third of the whole number of the board of directors. The directors of the first class shall be elected for a term of one year; the directors of the second class for a term of two

years; and the directors of the third class for a term of three years; and at each annual election the successors to the class of directors whose terms shall expire in that year shall be elected to hold office for the term of three years, so that the term of office of one class of directors shall expire in each year.

The number of the directors may be increased as may be provided in the by-laws. In case of any increase of the number of the directors the additional directors shall be elected as may be provided in the by-laws, by the Directors or by the stockholders at an annual or special meeting and one-third of their number shall be elected for the then unexpired portion of the term of the directors of the first class, one-third of their number for the unexpired portion of the term of the directors of the second class, and one-third of their number for the unexpired portion of the term of the directors of the third class, so that each class of directors shall be increased equally.

In case of any vacancy in any class of directors through death, resignation, disqualification or other cause, the remaining directors, by affirmative vote of a majority of the Board of Directors, may elect a successor to hold office for the unexpired portion of the term of the director whose place shall be vacant, and until the election of a successor.

The Board of Directors shall have power to hold their meetings outside of the State of New Jersey at such places as from time to time may be designated by the by-laws or by resolution of the Board. The by-laws may prescribe the number of directors necessary to constitute a quorum of the Board of Directors, which number may be less than a majority of the whole number of the directors.

Unless authorized by votes given in person or by proxy by stockholders holding at least two-thirds of the capital stock of the corporation, which is represented and voted upon in person or by proxy at a meeting specially called for that purpose or at an annual meeting, the Board of Directors shall not mortgage or pledge any of its real property, or any shares of the capital stock of any other corporation; but this prohibition shall not be construed to apply to the execution of any purchase-money mortgage or any other purchase-money lien. As authorized by the Act of the Legislature of the State of New Jersey passed

March 22, 1901, amending the 17th section of the Act Concerning Corporations (Revision of 1896), any action which theretofore required the consent of the holders of two-thirds of the stock at any meeting after notice to them given, or required their consent in writing to be filed, may be taken upon the consent of, and the consent given and filed by the holders of two-thirds of the stock of each class represented at such meeting in person or by proxy.

Any officer elected or appointed by the Board of Directors may be removed at any time by the affirmative vote of a majority of the whole Board of Directors. Any other officer or employee of the Company may be removed at any time by vote of the Board of Directors, or by any committee or superior officer upon whom such power of removal may be conferred by the by-laws or by vote of the Board of Directors.

The Board of Directors, by the affirmative vote of a majority of the whole board, may appoint from the directors an executive committee, of which a majority shall constitute a quorum; and to such extent as shall be provided in the by-laws, such committee shall have and may exercise all or any of the powers of the Board of Directors, including power to cause the seal of the corporation to be affixed to all papers that may require it.

The Board of Directors, by the affirmative vote of a majority of the whole board, may appoint any other Standing Committees, and such Standing Committees shall have and may exercise such powers as shall be conferred or authorized by the by-laws.

The Board of Directors may appoint not only other officers of the Company, but also one or more vice-presidents, one or more assistant treasurers and one or more assistant secretaries; and, to the extent provided in the by-laws, the persons so appointed respectively shall have and may exercise all the powers of the president, of the treasurer, and of the secretary, respectively.

The Board of Directors shall have power from time to time to fix and to determine and to vary the amount of the working capital of the Company; and to direct and determine the use and disposition of any surplus or net profits over and above the capital stock paid in; and in its discretion the Board of Directors may use and apply any such surplus or accumulated

profits in purchasing or acquiring its bonds or other obligations, or shares of its own capital stock, to such extent and in such manner and upon such terms as the Board of Directors shall deem expedient; but shares of such capital stock so purchased or acquired may be resold, unless such shares shall have been retired for the purpose of decreasing the Company's capital stock as provided by law.

The Board of Directors from time to time shall determine whether and to what extent, and at what times and places, and under what conditions and regulations, the accounts and books of the corporation, or any of them, shall be open to the inspection of the Stockholders, and no Stockholder shall have any right to inspect any account or book or document of the corporation, except as conferred by Statute or authorized by the Board of Directors, or by a resolution of the Stockholders.

Subject always to by-laws made by the Stockholders, the Board of Directors may make by-laws, and, from time to time, may alter, amend or repeal any by-laws; but any by-laws made by the Board of Directors may be altered or repealed by the Stockholders at any annual meeting, or at any special meeting, provided notice of such proposed alteration or repeal be included in the notice of the meeting.

In witness whereof, we have hereunto set our hands and seals the 23rd day of February, 1901.

CHARLES C. CLUFF
WILLIAM J. CURTIS
CHARLES MACVEAGH

Signed, sealed and delivered }
in the presence of }

FRANCIS LYNDE STETSON
VICTOR MORAWETZ.

STATE OF NEW JERSEY, } ss:
COUNTY OF HUDSON, }

Be it remembered that on this 23rd day of February, 1901, before the undersigned, personally appeared Charles C. Cluff, William J. Curtis and Charles MacVeagh, who, I am satisfied, are the persons named in and who executed the foregoing cer-

tificate; and I having first made known to them, and to each of them, the contents thereof, they did each acknowledge that they signed, sealed and delivered the same as their voluntary act and deed.

GEO HOLMES

Master in Chancery of New Jersey.

10ct. Internal Revenue Stamp Cancelled.

Endorsed "Received in the Hudson Co, N. J., Clerk's Office, February 25th A.D. 1901, and Recorded in Clerk's Record No. on page

MAURICE J. STACK

Clerk.

Endorsed "Filed Feb. 25, 1901.

GEORGE WURTS

Secretary of State.

FORM 63

CHARTER OF A PURE SECURITIES-HOLDING CORPORATION

CERTIFICATE OF INCORPORATION OF NORTHERN SECURITIES COMPANY¹

STATE OF NEW JERSEY, ss:

We, the undersigned, in order to form a corporation for the purposes hereinafter stated, under and pursuant to the provisions of the act of the legislature of the State of New Jersey entitled "An act concerning corporations" (revision of 1896), and the acts amendatory thereof and supplemental thereto, do hereby certify as follows:

First. The name of the corporation is Northern Securities Company.

Second. The location of its principal office in the State of New Jersey is at No. 51 Newark Street, in the city of Hoboken, county of Hudson. The name of the agent therein, and in charge

¹ Taken from *Northern Securities Co. v. United States*, 193 U. S. 197, pp. 216-221.

thereof, upon whom process against the corporation may be served, is Hudson Trust Company. Such office is to be the registered office of the corporation.

Third. The objects for which the corporation is formed are:

(1) To acquire by purchase, subscription, or otherwise, and to hold as investment, any bonds of other securities or evidences of indebtedness, or any shares of capital stock created or issued by any other corporation or corporations, association or associations, of the State of New Jersey, or of any other State, Territory, or country.

(2) To purchase, hold, sell, assign, transfer, mortgage, pledge, or otherwise dispose of any bonds or other securities or evidences of indebtedness created or issued by any other corporation or corporations, association or associations, of the State of New Jersey, or of any other State, Territory, or country, and while owner thereof to exercise all the rights, powers, and privileges of ownership.

(3) To purchase, hold, sell, assign, transfer, mortgage, pledge, or otherwise dispose of shares of the capital stock of any other corporation or corporations, association or associations, of the State of New Jersey, or of any other State, Territory, or country, and while owner of such stock to exercise all the rights, powers, and privileges of ownership, including the right to vote thereon.

(4) To aid in any manner any corporation or association of which any bonds or other securities or evidences of indebtedness or stock are held by the corporation, and to do any acts or things designed to protect, preserve, improve, or enhance the value of any such bonds or other securities or evidences of indebtedness or stock.

(5) To acquire, own and hold such real and personal property as may be necessary or convenient for the transaction of its business.

The business or purpose of the corporation is from time to time to do any one or more of the acts and things herein set forth.

The corporation shall have power to conduct its business in other States and in foreign countries, and to have one or more offices out of this State, and to hold, purchase, mortgage, and convey real personal property out of this State.

Fourth. The total authorized capital stock of the corporation

is four hundred million dollars (\$400,000,000), divided into four million (4,000,000) shares of the par value of one hundred dollars (\$100) each. The amount of the capital stock with which the corporation will commence business is thirty thousand dollars.

Fifth. The names and post-office addresses of the incorporators, and the number of shares of stock subscribed for by each (the aggregate of such subscriptions being the amount of capital stock with which the company will commence business), are as follows:

<i>Name and post-office address</i>	<i>Number of shares</i>
George F. Baker, Jr., 258 Madison avenue, New York, N. Y.	100
Abram M. Hyatt, 214 Allen avenue, Allenhurst, N. Y.	100
Richard Trimble, 53 East Twenty-fifth street, New York, N. Y.	100

Sixth. The duration of the corporation shall be perpetual.

Seventh. The number of directors of the corporation shall be fixed from time to time by the by-laws; but the number, if fixed at more than three, shall be some multiple of three. The directors shall be classified with respect to the time for which they shall severally hold office by dividing them into three classes, each consisting of one-third of the whole number of the board of directors. The directors of the first class shall be elected for a term of one year, the directors of the second class for a term of two years, and the directors of the third class for a term of three years; and at each annual election the successors to the class of directors whose term shall expire in that year shall be elected to hold office for the term of three years, so that the term of office of one class of directors shall expire in each year.

In case of any increase of the number of the directors the additional directors shall be elected as may be provided in the by-laws, by the director or by the stockholders at an annual or special meeting, and one-third of their number shall be elected for the then unexpired portion of the term of the directors of the first class, one third of their number for the unexpired portion of the term of the directors of the second class, and one-third of their number for the unexpired portion of the term of the directors of the third class, so that each class of directors shall be increased equally.

In case of any vacancy in any class of directors through death, resignation, disqualification, or other cause, the remaining directors, by affirmative vote of a majority of the board of directors, may elect a successor to hold office for the unexpired portion of the term of the director whose place shall be vacant, and until the election of a successor.

The board of directors shall have power to hold their meetings outside the State of New Jersey at such places as from time to time may be designated by the by-laws, or by resolution of the board. The by-laws may prescribe the number of directors necessary to constitute a quorum of the board of directors, which number may be less than a majority of the whole number of the directors.

As authorized by the act of the legislature of the State of New Jersey passed March 22, 1901, amending the seventeenth section of the act concerning corporations (revision of 1896), any action which theretofore required the consent of the holders of two-thirds of the stock at any meeting after notice to them given, or required their consent in writing to be filed, may be taken upon the consent of, and the consent given and filed by, the holders of two-thirds of the stock of each class represented at such meeting in person or by proxy.

Any officer elected or appointed by the board of directors may be removed at any time by the affirmative vote of a majority of the whole board of directors. Any other officer or employee of the corporation may be removed at any time by vote of the board of directors, or by any committee or superior officer upon whom such power of removal may be conferred by the by-laws or by vote of the board of directors.

The board of directors, by the affirmative vote of a majority of the whole board, may appoint from the directors an executive committee, of which a majority shall constitute a quorum, and to such extent as shall be provided in the by-laws such committee shall have and may exercise all or any of the powers of the board of directors, including power to cause the seal of the corporation to be affixed to all papers that may require it.

The board of directors may appoint one or more vice-presidents, one or more assistant treasurers, and one or more assistant secretaries, and, to the extent provided in the by-laws, the persons

so appointed, respectively, shall have and may exercise all the powers of the president, of the treasurer, and of the secretary respectively.

The board of directors shall have power from time to time to fix and determine and to vary the amount of the working capital of the corporation; to determine whether any, and if any, what part of any accumulated profits shall be declared in dividends and paid to the stockholders; to determine the time or times for the declaration and payment of dividends, and to direct and to determine the use and disposition of any surplus or net profits over and above the capital stock paid in; and in its discretion the board of directors may use and apply any such surplus or accumulated profits in purchasing or acquiring its bonds or other obligations, or shares of the capital stock of the corporation to such extent and in such manner and upon such terms as the board of directors shall deem expedient; but shares of such capital stock so purchased or acquired may be resold, unless such shares shall have been retired for the purpose of decreasing the capital stock of the corporation to the extent authorized by law.

The board of directors, from time to time shall determine whether and to what extent, and at what times and places and under what conditions and regulations, the accounts and books of the corporation, or any of them, shall be open to the inspection of the stockholders, and no stockholders shall have any right to inspect any account or book or document of the corporation except as conferred by statute of the State of New Jersey, or authorized by the board of directors or by a resolution of the stockholders.

The board of directors may make by-laws, and from time to time may alter, amend, or repeal any by-laws; but any by-laws made by the board of directors may be altered or repealed by the stockholders at any annual meeting or at any special meeting, provided notice of such proposed alteration or repeal be included in the notice of the meeting.

In witness whereof we have hereunto set our hands and seals the 12th day of November, 1901.

Signed, sealed and acknowledged by Geo. F. Baker, Jr., Abram M. Hyatt and Richard Trimble.

D. SPECIMENS OF REGULATORY LAWS

FORM 64

SHERMAN ANTI-TRUST ACT

An act to protect trade and commerce against unlawful restraints and monopolies, approved July 2, 1890. 26 Stat, at L. 209.

Section 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Section 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Section 3. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce in any territory of the United States or of the District of Columbia, or in restraint of trade or commerce between any such territory and another, or between any such territory or territories and any state or states or the District of Columbia, or with foreign nations, or between the District of Columbia and any state or states or foreign nations, is hereby declared illegal. Every person who shall make any such contract or engage in any such combination or conspiracy shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by im-

prisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Section 4. The several circuit courts of the United States are hereby invested with jurisdiction to prevent and restrain violations of this act; and it shall be the duty of the several district attorneys of the United States, in their respective districts, under the direction of the Attorney-General, to institute proceedings in equity to prevent and restrain such violations. Such proceedings may be by way of petition setting forth the case and praying that such violations shall be enjoined or otherwise prohibited. When the parties complained of shall have been duly notified of such petition the court shall proceed, as soon as may be, to the hearing and determination of the case; and pending such petition and before final decree the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises.

Section 5. Whenever it shall appear to the court before which any proceeding under section four of this act may be pending that the ends of justice require that other parties should be brought before the court, the court may cause them to be summoned, whether they reside in the district in which the court is held or not; and subpoenas to that end may be served in any district by the marshal thereof.

Section 6. Any property owned under any contract or by any combination, or pursuant to any conspiracy (and being the subject thereof) mentioned in section one of this act, and being in the course of transportation from one state to another, or to a foreign country, shall be forfeited to the United States, and may be seized and condemned by like proceedings as those provided by law for the forfeiture, seizure and condemnation of property imported into the United States contrary to law.

Section 7. Any person who shall be injured in his business or property by any other person or corporation by reason of anything forbidden or declared to be unlawful by this act, may sue therefor in any circuit court of the United States in the district in which the defendant resides or is found, without respect to the amount in controversy, and shall recover three-fold the damages by him sustained, and the costs of suit, including a reasonable attorney's fee.

Section 8. That the word "person," or "persons," wherever used in this act shall be deemed to include corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the territories, and the laws of any state, or the laws of any foreign country.

FORM 65

ANTI-TRUST ACT OF THE STATE OF KANSAS

Be it enacted by the Legislature of the State of Kansas:

Section 1. That all arrangements, contracts, agreements, trusts or combinations between persons or corporations made with a view or which tend to prevent full and free competition in the importation, transportation or sale of articles of domestic growth or product of domestic raw material, or in the loan or use of money, or to fix attorneys' or doctors' fees, and all arrangements, contracts, trusts or combinations between persons or corporations designed or which tend to advance, reduce or control the price or the cost to the producer or to the consumer of any such products or articles,—are hereby declared to be against public policy, unlawful and void.

Section 2. It shall not be lawful for any corporation to issue or to own trust certificates, other than the regular and lawfully authorized stock thereof, or for any corporation, agent, officer or employes, or the directors or stockholders of any corporation, to enter into any combination, contract or agreement with any person or persons, corporation or corporations, or with any stockholder or director thereof, the purpose and effect of which combination, contract or agreement, shall be to place the management or control of such combination or combinations, or the manufactured product thereof, in the hands of any trustee or trustees, with the intent to limit or fix the price or lessen the production and sale of any article of commerce, use, or consumption, or to prevent, restrict, or diminish the manufacture or output of any such article.

Section 3. That all persons entering into any such arrangement, contract, agreement, trust, or combination, or who shall, after the passage of this act, attempt to carry out or act under

any such arrangement, contract, agreement, trust or combination described in sections one or two of this act, either on his own account or as agent or attorney for another, or as an officer, agent or stockholder of any corporation, or as a trustee, committee, or in any capacity whatever, shall be guilty of a misdemeanor, and on conviction thereof shall be subject to a fine of not less than one hundred dollars and not more than one thousand dollars, and to imprisonment not less than thirty days and not more than six months, or to both such fine and imprisonment, in the discretion of the court.

FORM 66

MARYLAND'S BLUE SKY LAW

CHAPTER NO. 552.

An ACT to prevent fraud respecting securities offered for sale within the State of Maryland, and to provide a summary proceeding therefor, and for other purposes relating thereto, by adding four (4) additional sections to Article 32A of the Annotated Code of Public General Laws of Maryland, entitled "Department of Law," to be numbered 11, 12, 13 and 14.

Section 1. *Be it enacted by the General Assembly of Maryland,* That (4) new sections are hereby added to Article 32A of the Annotated Code of Public General Laws of Maryland, entitled "Department of Law," to be known as Sections 11, 12, 13 and 14, for the purpose of preventing fraud respecting securities offered for sale in the State of Maryland, and to provide a summary proceeding therefor, and for other purposes relating thereto, said sections to read as follows:

Section 11. If it shall appear to the Attorney General of the State of Maryland that in the issuance, sale, promotion, negotiation, advertisement of, or distribution of any stocks, bonds, notes or other securities within the State of Maryland, any person, partnership or corporation is employing or is about to employ any device, scheme or artifice to defraud, or for obtaining money or property by means of any false or fraudulent pretense, representation or promise, or the said Attorney General believes it to

be in the interest of the public that an investigation be made with a view to the issuance of an order, such as herein provided, he may require such person, partnership or corporation to file with him a statement in writing under oath as to all facts concerning the same, and for that purpose may prescribe forms upon which said statements shall be made. The Attorney General may require, in addition thereto, such further data and information as he may deem relevant and make such special investigation as may be necessary and for the purposes of this Act the Attorney General, or an Assistant Attorney General duly authorized by him, shall have power to require by subpoena or summons, the attendance and testimony of witnesses and the production of any books, accounts, records, papers and correspondence relating to any matter which the Attorney General is authorized by this Act to consider or investigate. The Attorney General, or his duly authorized assistant, may sign subpoenas, administer oaths and affirmations, examine witnesses and receive evidence. In case of disobedience to a subpoena or of the contumacy of any witness appearing before the Attorney General or his duly authorized Assistant Attorney General, the Attorney General may invoke the aid of the Circuit Court of any of the counties of the State of Maryland, or of the Superior Court of Baltimore City. Such court may thereupon issue an order requiring the person subpoenaed to obey the subpoena or to give evidence or produce books, accounts, records, papers and correspondence touching the matter in question. Any failure to obey such order of the court may be punished by such court as a contempt thereof. In the case of a failure or refusal of any person, partnership or corporation concerned in the issuance, sale, offer for sale, promotion, advertisement or distribution of any stocks, bonds, notes, or other securities within the State of Maryland, to file any statement or to furnish any information, books, papers or records required by the Attorney General or his duly authorized assistant, to be filed or furnished in connection with such investigation under this Act, the Attorney General may issue his order under Section 12 of this Act.

Section 12. The Attorney General may, upon evidence satisfactory to him, that in the issue, sale, promotion, negotiation, advertisement of, or distribution of any stocks, bonds, notes or

other securities within the State of Maryland, any person, partnership or corporation is employing or is about to employ any device, scheme or artifice to defraud, or for obtaining money or property by means of any false or fraudulent pretense, representation or promise, issue and cause to be served upon such person, partnership or corporation an order requiring the party guilty thereof to cease and desist therefrom. If it shall appear to the Attorney General that an irreparable public injury is imminent unless such an order is issued before a full investigation can be made pending such investigation, he may issue such order but the same shall be accompanied with a request for information as to the facts relied on in issuing the order, and such temporary order shall only remain in force until such information is furnished and two days thereafter. Orders of the Attorney General under this section may be served by anyone duly authorized by the Attorney General either (a) by delivering a copy thereof to the person to be served; or to a member of the partnership to be served, or to the president, vice-president, secretary or other executive officer or director of the corporation to be served; or (b) by leaving a copy thereof at the principal office or place of business of such person, partnership or corporation; or (c) by registering and mailing a copy thereof, addressed to such person, partnership or corporation at his or its principal office or place of business. A verified return by the person so serving said order, setting forth the manner of said service, shall be prima facie proof of the same, and the return postoffice receipt for said order registered and mailed as aforesaid shall be prima facie proof of the service of the same, as aforesaid.

Section 13. Any person, partnership or corporation affected or aggrieved by the order of the Attorney General under Section 12 shall be entitled to a hearing de novo before the Circuit Court of the county in which said person, partnership or corporation has performed or is alleged to have performed the acts referred to in said order of the Attorney General, or in the Superior Court of Baltimore City, if said acts or alleged acts occurred in Baltimore City, or, at the option of said person, partnership or corporation, said proceeding for a hearing de novo may be filed in the Circuit Court for the County in which said person, partnership or corporation resides or has its principal office

within the State of Maryland, or in the Superior Court of Baltimore City, if such residence or office is in Baltimore City. And in such proceeding any such person, partnership or corporation shall be entitled to have any issues of facts arising therein determined by a jury, provided written demand is filed at the time of the institution of said proceeding. The court shall have power during the pendency of the proceeding before it, to suspend or modify the order of the Attorney General and to enter an appropriate judgment or order at the conclusion of such hearing to modify, affirm or set aside order. From the final order or judgment of the said court, either party to said proceeding may appeal to the Court of Appeals of Maryland as in other cases or suits at law arising in said court; and, in case of such appeal, the testimony adduced before the court shall be presented to the Court of Appeals by bills of exception in customary form, as in other law cases, and the Court of Appeals may review the questions of law arising on said appeal as in other appeals from courts of law and in ordinary course.

Section 14. Any person, partnership or corporation having been served with any order of the Attorney General under Section 12 of this Act, or having knowledge of the issuance of said order and while said order remains in effect, either as originally issued or as modified, who or which shall execute or carry on in any manner any scheme or device against said order has been issued, or wilfully attempts so to do, or shall sell or deliver or receive payment in money or property for any paper, certificate or instrument purporting to be or represent any interest in or order, for stocks, bonds, notes or other securities mentioned in said order of the Attorney General, or shall publish or cause to be published any advertisement of any such stocks, bonds, notes or other securities pursuant to said scheme or device against which said order has been issued, shall be guilty of a misdemeanor and, upon conviction, shall be fined not more than ten thousand dollars (\$10,000) or imprisoned not more than two years, or be subject to both fine and imprisonment, in the discretion of the court.

Section 2. *Be it enacted*, That this Act shall take effect June 1, 1920.

Approved April 16, 1920.

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